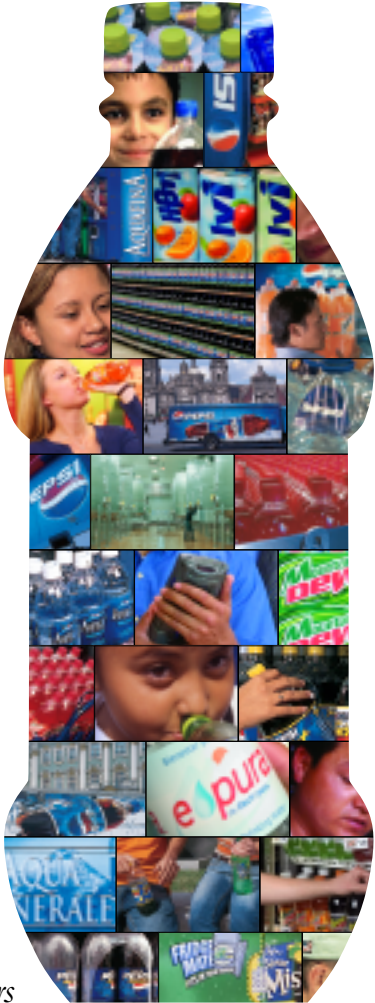
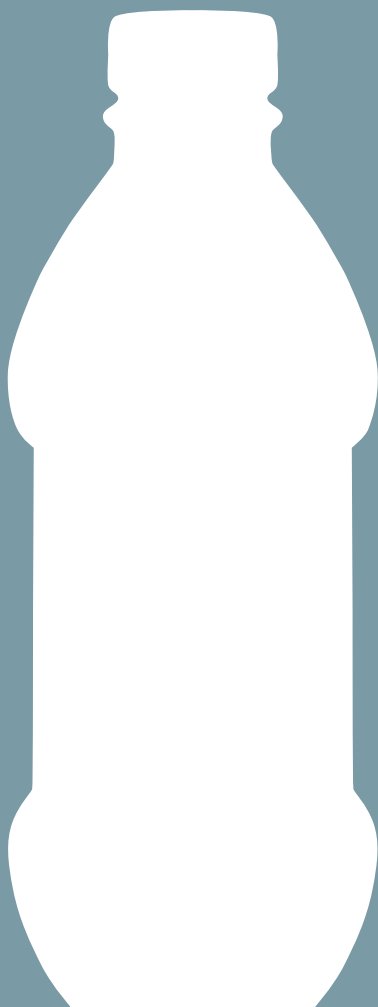


2004
ANNUAL
REPORT

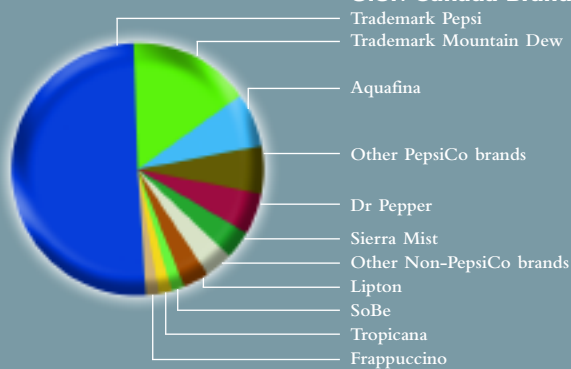
Inside Matters

The Pepsi Bottling Group, Inc. is the world's largest manufacturer, seller and distributor of carbonated and non-carbonated Pepsi-Cola beverages.

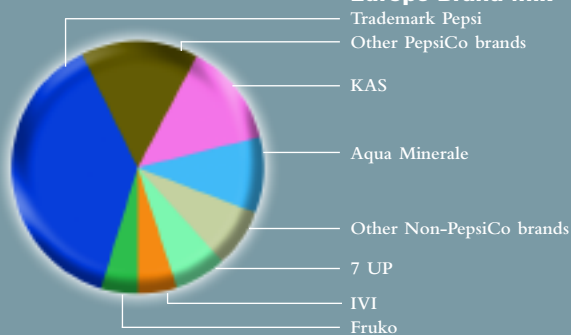
<i>2004 Facts about PBG</i>	<i>U.S.</i>	<i>Outside the U.S.</i>	<i>Total</i>
Number of Plants:	46	50	96
Number of Distribution Centers:	254	267	521
Number of Employees:	31,700	33,000	64,700
Percentage of Volume:	61%	39%	100%



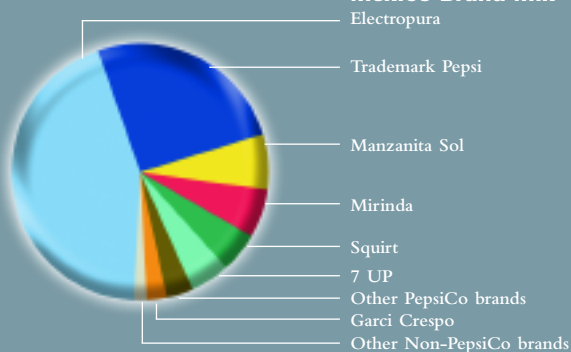
U.S. / Canada Brand Mix



Europe Brand Mix



Mexico Brand Mix



Financial Highlights

\$ in millions, except per share data

	2004	2003	2002
Net Revenues	\$10,906	\$10,265	\$9,216
Pro Forma Net Revenues ¹	\$10,906	\$10,265	\$8,926
Operating Income	\$ 976	\$ 956	\$ 898
Diluted EPS	\$ 1.73	\$ 1.50	\$ 1.46
Pro Forma Diluted EPS ²	\$ 1.73	\$ 1.56	\$ 1.46
Net Cash Provided by Operations	\$ 1,251	\$ 1,084	\$1,014
Capital Expenditures	\$ (717)	\$ (644)	\$ (623)
Net Cash Provided by Operations, less Capital Expenditures	\$ 534	\$ 440	\$ 391

¹ Fiscal year 2002 has been adjusted to reflect the adoption of Emerging Issues Task Force (EITF) Issue No. 02-16. For reconciliation of Pro Forma Net Revenues, see page 42.

² Fiscal year 2003 Diluted EPS of \$1.50 was adjusted by adding \$0.04 for the impact of a Canadian tax law change and \$0.02 for the cumulative effect of change in accounting principle (impact of adoption of EITF 02-16). For additional information on the impact of EITF 02-16, see page 42. For additional information on the Canadian tax law change, see page 52. 2004 Pro Forma Diluted EPS growth versus the prior year was 11%, which is mentioned in the Chairman's Letter.

Chairman's Letter

Page 2

PBG / U.S. and Canada

Page 4

PBG / Mexico

Page 8

PBG / Europe

Page 10

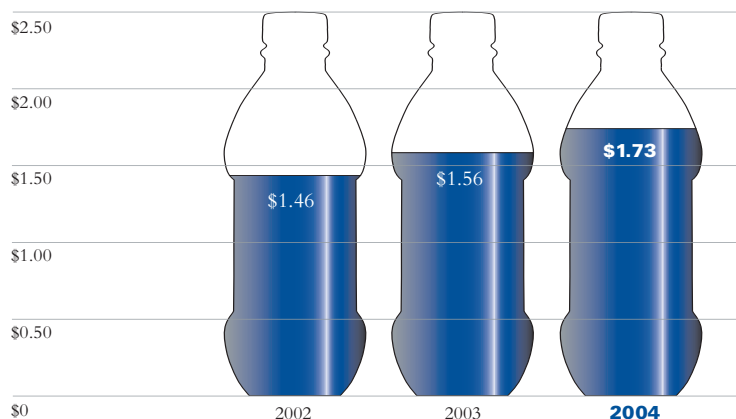
Board of Directors

Page 12

Financial Review

Page 13

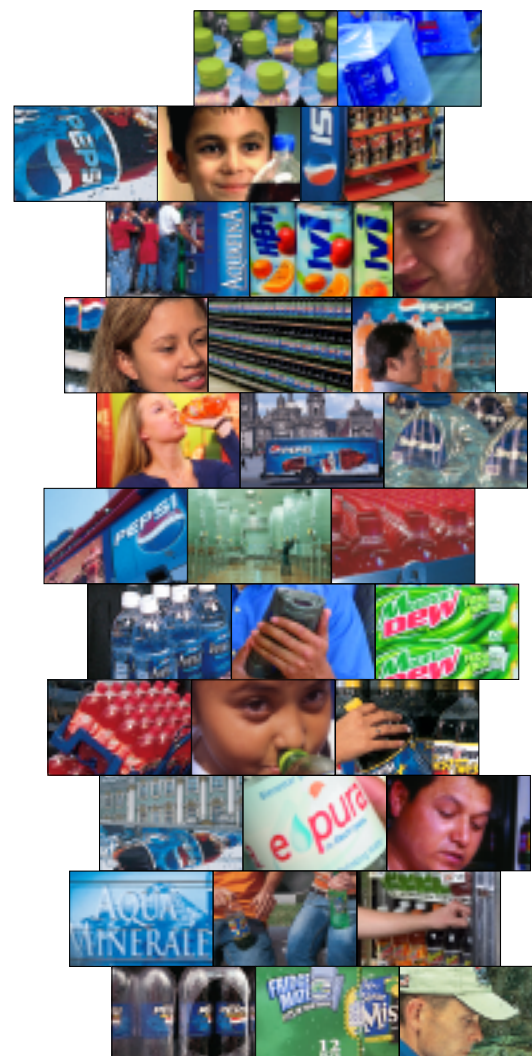
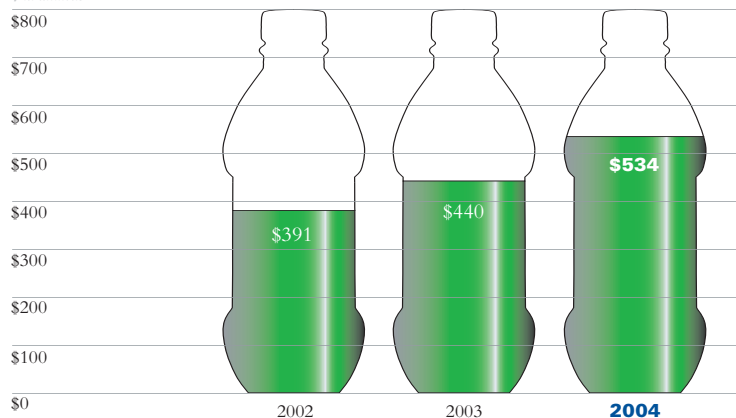
Pro Forma Diluted Earnings Per Share



Net Cash From Operations, less Capital Expenditures

Cumulative Average Growth Rate 17%

\$ in millions



Chairman’s Letter

Dear Fellow Shareholders,

In this year’s annual report, I invite you inside our business to meet three outstanding PBG leaders – Eric Foss, one of the most dynamic executives in the beverage industry, whose ability to design clear objectives and inspire our employees to take action is a huge advantage for us in the U.S. and Canada; Rogelio Rebolledo, whose broad back-ground in understanding consumer needs and business dynamics in different countries and environments is making a difference in our newest acquisition of Mexico; and Yiannis Petrides, whose knowledge of his markets, great decision-making capability and sensitivity to customer issues have driven huge progress in our European business. You’ll get a sense of what motivates them and how they lead their teams to success.

You’ll also see that at PBG, what’s inside matters. Quality products. Disciplined revenue management. Strong financial controls. Excellence in everything we do. And the best people in the industry – in leadership positions and at the front line. All this adds up to what matters to you – results.

The Numbers – 2004

- Diluted earnings per share were \$1.73 for the full year, an 11 percent increase.
- Return on invested capital increased to 7.7 percent, ahead of our 7 percent weighted-average cost of capital.
- Net cash provided by operations less capital expenditures grew by 21 percent to \$534 million.

- On a constant territory* basis, both U.S. and worldwide volume were up 2 percent in physical cases.

- Net revenue per case growth was up 3 percent, both in the U.S. and worldwide.

- Total topline growth was 6 percent, the most balanced we’ve achieved in any year since our Initial Public Offering in 1999.

Growing the Topline

Once again, consumer demand for variety and value drove our initiatives. Innovation played a starring role in our progress. In the U.S., we began the year with the very successful launch of Tropicana juice drinks, carving out a solid second place in this category in less than a year. We continued to pulse “in and out” products into the market, including a reappearance of Mountain Dew Live Wire and the intro- ductions of Mountain Dew Pitch Black and Pepsi Holiday Spice. In Canada, Tropicana Twister was big news and moved to the top of the category.

In Mexico, we introduced Pepsi Twist with lime and line extensions of two of our powerhouse flavor brands, Mirinda and Manzanita Sol. We relaunched our bottled water under a new brand name, EPura. Redesigned to appeal to our target audience of young, health-conscious consumers, the product posted impressive volume growth of more than 20 percent in the fourth quarter after its introduction.

Our European operations had strong results, fueled by innovation and product line extensions. We launched Tropicana juice and 7 UP Ice in Russia, as well as expanding our Lipton and Gatorade distribution. We acquired a major restau- rant group as a new customer in Spain, and showed explosive volume growth across categories in Turkey.

New packages also provided new ways to meet consumer needs. In the U.S. and Canada, we launched the eight-ounce can multi-pack to appeal to drinkers who prefer smaller portions; expanded the rollout of the Fridgemate package, designed to do what its name implies – allow better access to refrigerated beverages – and in Mexico, Russia and Greece, we introduced new plastic bottles that have been a hit with con- sumers. The contoured shape of these packages makes them easier to grip and pour, important attributes in marketplaces where multi-serve PET packages are the biggest volume drivers.

Across our markets, consumer value is central to our strategy. We tailor our brands and packages to consumer wants and needs. Then we focus on ensuring that our beverages are available in the places where consumers shop, eat and work ... and always at attractive price points.

Managing Cost Pressures

Our topline growth was impressive in 2004, but external dynamics had a signifi- cant impact on our ability to translate it to bottom line results. The rate of inflation on key raw materials used to make our products had been relatively stable for almost a decade. In 2004, all of that changed. Global supply and demand for sweeteners, aluminum used in can production and the resin used to make our PET packaging drove the cost of all three critical raw materials up substan- tially. When all was said and done, these increases added \$80 million to our cost of goods sold, putting significant pressure on our profits.

While these marketplace conditions were difficult, we did not lose sight of our focus: continuing to execute our programs with excellence and securing pricing and mak- ing the right investments for future growth.

Investing in Growth and Capability

Selling excellence training for our sales force continued to be an area of invest- ment for the third consecutive year. More than 5,000 frontline employees are now certified in PBG’s selling methods, bringing a level of consistency to every sales call and allowing us to be very responsive to our customers. This training, which has worked so well in our U.S. operations, has become a best practice and is moving to other geographies, such as Russia, which has adopted the curriculum and customized it to address local selling situations.

We’ve continued our focus on diversity, with emphasis on providing the right products, promotions and service for our multicultural markets. We’re also strength- ening our workforce by attracting, developing and retaining employees whose varying viewpoints and life experiences bring richness to our work environment and business perspective. We’re pleased that *Diversity Inc.* magazine acknowledged our progress in both of these areas by including us in their 2004 list of Top Companies for Diversity. We’re proud of this recognition, but know that we have more work to do to ensure that we are ready to address the market- place of the future. Our focus will continue in 2005 and beyond.

We invested in capacity by building our first new plant in more than a decade, a 330,000 square foot state-of-the-art facility in Virginia.

And we continued to grow through acquisitions, adding four businesses in the U.S., Canada and Mexico to PBG’s operations.

Building the Future

We expect our share of challenges in 2005. But, we’re prepared – with realistic plans, targeted investments in both the marketplace and our people, and the flexibility to respond to whatever con- sumer, customer or competitive dynamics take place. PBG’s next frontier is to take our already strong customer service to new heights. We plan to do this with initiatives designed to enhance our cus- tomer relationships and our performance. Our work has been driven by our customers, who have explained their biggest challenges and what they need to succeed going forward. We intend to ensure their needs are met. We want to be their supplier of choice, today and in the future.

At PBG, what matters to us is what’s inside. Inside our products. Inside our plans. And most of all, inside our people. All of it adds up to our formula for success:

- We work with PepsiCo to bring products to market that meet consumers’ ever-changing needs.
- We help our customers build their businesses using the power of our category, the speed and reach of our direct store delivery system and our commitment to exceed their expectations.

- We manage our revenue with discipline – understanding the levers we control and the dynamics of each PBG market.

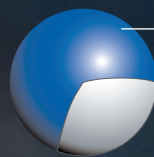
- We choose the best employees to join our team. People who share our values, our work ethic and our sense of urgency. Eric, Rogelio and Yiannis set the pace. We have a strong bench behind them running our operations in the 67 markets where we do business. And then, there are the thousands of frontline employees who are PBG’s face to the customer. What’s inside them is what matters most of all. Their accomplishments are the single biggest reason we’ve come so far. Their executorial excellence and desire to win make us sure that we are capable of so much more.



John T. Cahill

John T. Cahill
Chairman of the Board and
Chief Executive Officer

*Constant territory calculations assume all significant acquisitions made in 2003 were made at the beginning of 2003 and exclude all significant acquisitions made in 2004.



U.S. and Canada produced 68% of PBG's total volume in 2004

“The growing product variety in our portfolio has become an advantage that we can leverage with our customers.”

Where is PBG's topline growth coming from over the next three years in the U.S. and Canada? In the U.S. and Canada, there are three big topline areas of opportunity for us. First of all, we start from a position of strength with four anchor brands that are leaders in their respective segments: brand Pepsi in colas, Sierra Mist and Mountain Dew in flavors, and Aquafina water in non-carbs. So in part, topline growth will come from building our base business across those four powerful brand platforms.

Our second source of growth is from innovation that brings incremental volume to our business. This has a brand dimension and a package dimension. We've done a lot to extend the cola franchise, with the addition of Pepsi Twist and Pepsi Vanilla. Mountain Dew is a great trademark to extend. With its high brand loyalty, yet low household penetration, it presents a great opportunity for growth. The additions of Mountain Dew Code Red, Live Wire and Pitch Black gave us a lot of momentum and a strong track record to continue to expand on the Mountain Dew trademark.

In packaging innovation, opportunities lie in single-serve innovation, take-home PET innovation and can innovation. In single-serve innovation, we've developed a three-tiered approach to meet the needs of every type of user. The 14-ounce package for light use, the 20-ounce for medium use and the 1-liter package for heartier consumption. On the take-home PET side, we've had great success with a broad variety of multi-packs and package sizes, and we'll continue to add packaging options for both CSDs and non-carbs.

business, too. We'll also take that portability and storability concept into PET, with a FridgeMate for 12-ounce PET bottles.

Another area of topline opportunity is in “new growth opportunities” driven by our consumers. For example, the multicultural demographic shift taking place presents us with new ways to go to market, particularly in urban areas. The growing Hispanic market, for one, is a big opportunity for us today, as we continue to focus on products and marketing designed for Hispanic consumers.

The health and wellness emphasis in North America is also creating new opportunities for us. Our broad product portfolio already includes juices and juice drinks, energy drinks and, of course, water, ideally positioning us for this trend. But we're always looking for ways to enter emerging beverage categories that are perceived as “better for you.” And finally, we will need to enter into beverage segments that we're not in today to capture future topline growth.

So, the combination of building on our existing brand portfolio, expanding our portfolio through innovation and capitalizing on new growth platforms gives us plenty of promise for the future.

How do you define “executional leadership,” and how has it become a point of difference for PBG's business? Executional leadership is one of the core attributes to be a successful bottler. It's something we've nurtured since the IPO, and I think we've earned our spot among our bottling peers and the broad marketplace of packaged goods companies. Executional leadership has five dimensions.

The second dimension is selling excellence. We've invested a lot of time, effort and energy into building the capability and skills of our selling organization, making sure they have the right training, tools, processes and technology to do their jobs very effectively.

The third dimension of executional leadership is marketing or brand enhancement – having the right set of brands, the right brand positioning, the right promotional campaigns and the right in-store activation through point of sale materials. It also involves innovation and making sure we have the right and relevant consumer programs. One point of difference for us has been our Power of One platform – unique marketing and merchandising programs that combine the power of the brands we sell with those of Frito-Lay.

The fourth dimension is revenue and margin management excellence, and this has been a hallmark of PBG's success. We've been able to get 2 to 3 percent net revenue per-case growth annually by finding opportunities to take pricing up, and applying a fairly sophisticated model on mix management. The keys are to keep the consumer at the forefront of our decision-making process on price and value, and to understand the impact that our price/value equation has on our customers' businesses and trade margins.

The fifth, service excellence, is an area where we are spending more and more of our time. Our customers want, and deserve, great service. They expect us to solve their out-of-stock issues so they can maximize their sales and satisfy their consumers. They need us to call on their accounts as scheduled, so they can plan their own labor resources. If an issue arises,



Eric J. Foss
President
PBG North America

One thing consumers value most about packaging is portability and storability, reflected in the success of the FridgeMate can package we expanded in 2004. You'll see us build on FridgeMate's success with variations on its configuration to give it appeal, not just in our supermarket and other large format accounts, but in the small format segment of our

The first area is executional excellence – our organization's ability to be sure we have the look of a leader in our accounts – with the number of ad features we get, how much display space we occupy and how many points of availability we offer consumers. We've been very successful in driving continued improvement across those dimensions.

we need to resolve it in real time. And, as retailers do more and more of their business on weekends, they need us to provide capable selling and service staff seven days a week. We have a lot of work underway in this area, and over the next few years we'll become an even better service provider than we are today.

How is PBG capitalizing on the changes in the retail landscape and consumer shopping behavior? On the retail front, there is a lot of consolidation going on, particularly in the super-market sector, which we see as an opportunity. Because we're a very big, powerful company and a provider of our products across the U.S. and Canada, we have a scale advantage that helps us better serve retailers as they continue to consolidate. We work very closely with our customers, along with PCNA (Pepsi-Cola North America), to ensure we have dedicated resources, sales call coverage and a strong communication process to meet the needs of large retailers.

Consumers are shifting their shopping trip behavior out of the traditional supermarkets into supercenters, club stores and discount channels. This "channel migration" works to our advantage. These larger-format stores allow us to leverage the power of our direct store delivery (DSD) system, which is more effective than a warehouse system in those channels. Most other packaged goods companies don't have that broad reach advantage, or the ability to sell, deliver and merchandise their own products in these "mega" format stores.

How will bottled water contribute to PBG's volume and profit over the next several years? Water is the fastest-growing category in the liquid refreshment beverage industry, and it is expected to remain so for some time. PBG brings a number of distinct advantages to the marketplace that will allow us to capitalize on that growth.

Today, household penetration for bottled water is at a much lower level than carbonated soft drinks. As household penetration grows and as bottled water becomes a "destination category"

storing, loading and merchandising the product – we do that for them. Almost all of the category's profitability is from waters that are direct store delivered as opposed to warehoused.

Our selling and executional excellence are big advantages for our water business, as we bring our feature strategy, display inventory, executional skills and space management skills to the table. Another advantage is our ability to market and promote water just like we do carbonated soft drinks. We think bottled water is a "brandable" category. As time goes on, branding will become an even more important dimension. Our ability to come up with a great advertising campaign, the right brand positioning and really play up Aquafina's "purity" trademark will be an advantage for us over time.

Our goal has always been to grow our water business profitably. We have been and will continue to be successful at that.

How much higher can PBG take pricing, and still provide consumers with perceived value? On the pricing side of revenue management, we have a significant way to go before we reach the prices consumers were paying even a decade ago. There are almost no other packaged goods categories where the consumer has seen that kind of price value over the last 10 years. I believe we will have many more opportunities to take pricing up without sacrificing our consumer value proposition.

There continues to be a sea of opportunity on the side of mix management as well – that is, for us to sell more of our higher-profit packages. There are a number of ways we will continue to do that:

- Adding new, higher-margin packages to our lineup, such as our six-pack, 8-ounce cans.
- And finally, helping our mix management with "limited time offer" packages, which we pulse in and out of the marketplace. These give us incremental volume and add to our revenue and margin equation.

How is PBG adapting to the growing complexity of the industry? Complexity is here to stay, and it's largely driven by consumers. Consumers continue to seek more and more variety, and they perceive value differently across brands and packages. Great companies will respond by offering consumers more variety and innovation.

Complexity is a challenge, but it is also a great opportunity for us. We have spent and will continue to spend a lot of time building processes, tools and technology to simplify that complexity – for our frontline selling organization in particular. By doing that, we've established a strong foundation to take on additional products and packages going forward. Our selling organization embraces the complexity of our product portfolio as more "weapons in their selling arsenal." The growing product variety has become an advantage that they can leverage with our customers.

How does PBG's partnership with PCNA translate into a competitive advantage? Both PBG and PCNA work very hard at our partnership because we understand that our success is so closely entwined. We start with the principle that whatever the issue, we need to find the right solution for both of our systems. When we keep that principle top



for consumers, the demand for feature ad frequency and the display and merchandising intensity in stores will increase. That gives DSD companies such as PBG a powerful competitive advantage. DSD benefits our retail partners because they don't need to incur the costs of

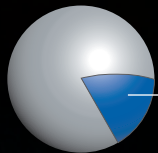
- Growing our cold drink business – which we do through improved in-store execution, innovation and promotions that drive repeat purchases.
- Accelerating the development of our take-home PET mix – particularly our 2-liter and 6 x 24-ounce package.

of mind, we end up making the right decisions for the marketplace. I think our commitment to mutual success has been reflected in the joint efforts we've produced, such as the amount and pacing of innovation, and the rich marketplace activity our consumers continue to experience.





**“To stay ahead, we must always
be thinking about what’s next,
and what’s after that.”**



Mexico produced
18% of PBG's total
volume in 2004

How is PBG Mexico responding to the rise of bargain brand sodas across Mexico?

Over the last few years, Mexico has experienced the emergence of a new category – the value brand. As the economy deteriorated and carbonated soft drink (CSD) prices rose, the conditions were ripe to exploit the opportunity of a lower price point. The “bargain brand” competitors emerged, offering consumer value in terms of quantity – more product for a lower price.

Today, Mexican consumers for the first time have the option to buy an alternate soft drink brand at a much lower price. We’ve also seen the emergence of “supercenters,” the perfect channel for the low-price competitors because these stores display attractive value propositions in a way consumers cannot miss.

We now need to address value in a very different way. Our 2005 initiatives will focus on promotions that give consumers an economic reason to purchase our product. We’re making sure that our products carry something that translates into an economic advantage – for example, a traditional under-the-cap promotion, with caps that can be exchanged for “free” product. When we combine the delivery of monetary value plus the equity value of our brands, the two should be powerful enough to offset a brand that is selling its product exclusively on the attractiveness of a big price discount. Consumers will realize that, along with exciting marketing appeal, we offer an impressive value.

What else is PBG doing to improve its competitive position? As the number two brand in Mexico, and in a market where most of the value brands are trying to make inroads,

In 2004, we added 13,000 customers to our base and placed 24,000 net coolers, and we’ll build on that progress. To stay ahead, we must always be thinking about what’s next, and what’s after that. PBG is going to compete quite differently than we did in the past.

What role will bottled and jug water play in growing PBG’s business in Mexico?

Whereas the CSD industry is quite mature in Mexico, the water industry does have double-digit growth potential. One of PBG’s strengths is that we have the infrastructure and experience to create a completely different, more favorable game in both bottled and jug water.

The jug water industry had not changed much for the last 10 or 15 years, but as with CSDs, we’re now seeing the emergence of low-price competition in the water category. We have to address that challenge, or our business will erode. The water industry is ready for transformation, and PBG is ideally positioned to lead it.

Since we are the largest competitor in the water segment with the Electropura brand, we have to be the innovators – if we let someone else do it, that could translate into market share losses. One example is packaging innovation. Many consumers don’t have a car, and must somehow get home with a 20-liter jug, the only package that was offered for a long time. This year we introduced the 10-liter and 11.3-liter jugs – much more convenient packages for consumers’ current shopping patterns. We’re also broadening Electropura distribution to reach a much greater number of households.

Bottled water has been a major source of growth for PBG in the U.S., but has not yet been exploited in Mexico. The dynamics of the bottled water business are very different from jug water. Jug water is purchased for safety and purity reasons; bottled water carries an image of health and a trendy personal lifestyle. To capitalize on this opportunity, in 2004 we launched a new concept for bottled water, under the name EPura. We’re fortunate to have the size and scale to market and distribute EPura broadly, and the initial results are quite promising.

What are PBG’s top priorities in Mexico? Taking cost out of our system is our number one priority. We needed to remove redundancies, reduce expenses and restructure PBG Mexico to make things simpler and more cost effective than when we acquired it. We’re well on our way.

Our second priority is reviving topline growth. The soft drink business in Mexico is a very mature industry, with per capita consumption at about the same level of the U.S., or even higher. As a result, we expect to see low single-digit growth for CSDs. The competitive environment and the arrival of bargain brands have caused us to adjust our pricing and to rethink our promotional calendar. We will continue to adjust our business proposition to ensure we achieve sustainable growth.

Our third priority is building organizational capability within PBG Mexico. That means building depth in the management team, and ensuring the company is developing business processes that will make it a premier organization. We need to build a culture that does



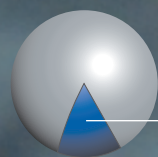
Rogelio Rebollo
President
PBG Mexico

we are fighting a real battle, and our ability to bring innovation to the market is critical. We’ve already introduced a new Pink KAS, lime-flavored Pepsi Twist and a new contoured bottle to name a few. And there is much more to come. We’ll continue expanding our reach as well, by securing more accounts and placing more cold-drink equipment in the marketplace.

In Mexico City alone, there are more than 20 million people in 5 million households, yet we had focused almost exclusively on “up and down the street” accounts where jug water is purchased. We’re now expanding to call directly on homes in selected areas of the city where the growth potential could be significant.

more with less. As that culture gets ingrained throughout the organization, we’ll see the results in the bottom line. At the top tier of management, we’re bringing in talented people who will be “beacons” of a new way of doing business. We want a management team that will never be completely satisfied, because the pursuit of improvement and excellence is a never-ending task.

“We’ve come a long way in improving capability across all of our territories, and we’re building on that progress.”



Europe produced
14% of PBG’s total
volume in 2004

What were your chief accomplishments in Europe in 2004? We finished 2004 with very strong results in Europe, overcoming a tough macroeconomic environment. Our mission is to make sure that PBG Europe is incremental to PBG’s topline and bottom-line growth. We have delivered that mission every single year, growing significantly faster than the rest of PBG. Excluding acquisitions, more than 50 percent of PBG’s global volume growth came from Europe – even though we are only about 14 percent of the mix.

We’ve come a long way in improving capability across all of our territories, and we’re building on that progress. In 2004, we took our already strong relationship with PepsiCo International to a higher level in terms of working much more closely and testing new ideas.

What are some of the unique marketplace dynamics in each country? Each country is in a different stage of economic development. Spain, our largest market in net revenue, has a mature economy with relatively high per capita income and high per capita consumption of CSDs. A big challenge there is to be more competitive with our Pepsi portfolio, which has a relatively low share, and address the rapid growth of the discount segment.

Russia is still emerging economically and is at a lower per capita income, with lower CSD consumption. We have been extremely successful in this country over the last few years. Our challenge is to continue to grow our volume and share profitably. In Russia, another challenge is to make sure we continue to fully leverage the “Power of One” portfolio – the strong presence we’ve established with the Pepsi and Frito-Lay brands.

third-party distributors to gain more control over how our products are displayed in the trade. We are also restructuring and reducing our cost base, which will enable us to be much more competitive.

In our smallest territory, Greece, we have to create enough “critical mass” so that we can be more competitive there. We will look to the strength of our local flavors, juices and bottled water under the IVI brand to drive our growth.

What actions has PBG taken in Europe to address the issue of capability? Improving capability has been our top priority for the last two years. One big advantage we have is the experience of PBG’s U.S. operations. Our objective is to take some of the best practices in the U.S. and transfer them to Europe. One way we do that is by moving people from Europe to the U.S., and then bringing them back with their newfound know-how and ideas. We also bring people from the U.S. to Europe, and then they return with fresh ideas and experience.

In selling capability, we have taken many of the tools developed in the U.S., such as Territory University training, and adapted them to the European market. In operations, we have applied many U.S. practices in quality and productivity in our countries. We also share best practices among the countries within Europe. Examples include Spain’s work on cost of goods and service productivity, which we’re applying to other countries. Ultimately, our success will depend on our ability to take the best of our processes, tools and disciplines and adapt them to the conditions of each market.

Is customer service as significant in Europe as it is in the U.S.? Absolutely. First, as the

In 2004, we conducted a customer service survey in all four countries. Based on our findings, each of the countries developed very detailed service targets and opportunities. We’ll be performing another survey in 2005 to track our progress versus our objectives, our major competitor and the “best in class.”

What part does innovation play in growing the European business? Consumers are asking for a lot more in product innovation, particularly in the “better-for-you” category – and we’ve been very active in answering this call. In Russia, for example, we adapted the Tropicana trademark to the market in 2004. We also introduced Lipton Iced Tea and Adrenaline Rush – all with great success.

Water is an important area for innovation. We now have a water brand in our portfolio in all four countries where we operate. In Russia, we also experimented with enhanced bottled waters. The third innovation area is in “light” or diet beverages, where we have seen a lot of growth and will be putting more emphasis.

We’ve learned much from the U.S. about linking package innovation to convenience. In 2004, we relaunched our CSD portfolio in Russia and Greece in an easy-to-grip contoured bottle, which we’ll expand into the balance of our European territories, along with other new package ideas in 2005. Innovation offers a strong opportunity in Europe, but we must ensure that it is incremental to our base business.

What is the outlook for PBG Europe? We have a fantastic proposition going for us. We have a great country mix in terms of per capita consumption and growth opportunities.

Yiannis Petrides
President
PBG Europe

And we need to expand our manufacturing, warehousing and logistics infrastructure to accommodate the growth of our business, while keeping an eye on costs.

Our challenge in Turkey, our most recent European acquisition, is to take the business to the next level of capability, and our team is making great progress. We’re working with our

retail trade consolidates, it becomes more sophisticated and requires more in terms of service. We must understand and meet their needs to remain competitive. Second, providing superior customer service enables us to create a competitive advantage in countries where the Pepsi brand equity is not as strong.

We have huge potential in terms of building capability over the long term, with so many things we can take from the U.S. to get us to the next level of performance. Most importantly, we have a great team of people whose knowledge and experience are second to none, and that makes me feel excited. I think the future is very bright for us in Europe.

Board of Directors



From left to right:

^{2,3} **Ira D. Hall**, 60, was elected to the Board in March 2003. Mr. Hall retired as President and Chief Executive Officer of Utendahl Capital Management, L.P. in December 2004, a position he held since 2002.

^{1,3} **Linda G. Alvarado**, 52, was elected to PBG's Board in March 1999. She is the President and Chief Executive Officer of Alvarado Construction, Inc., a general contracting firm specializing in commercial, industrial, environmental and heavy engineering projects, a position she assumed in 1976.

^{2,3} **Susan D. Kronick**, 53, was elected to PBG's Board in March 1999. Ms. Kronick became Vice Chairman of Federated Department Stores in February 2003. Previously, she had been Group President of Federated Department Stores since April 2001.

^{1,3} **Thomas H. Kean**, 69, was elected to PBG's Board in March 1999. Mr. Kean has been the President of Drew University since 1990, and was the Governor of the State of New Jersey from 1982 to 1990. Mr. Kean was also Chairman of The National Commission on Terrorist Attacks Upon the U.S.

Clay G. Small, 54, was elected to PBG's Board in May 2002. Mr. Small is Vice President and Deputy General Counsel – PepsiCo.

John T. Cahill, 47, was elected to PBG's Board in January 1999 and became Chairman of the Board in January 2003. He has been our Chief Executive Officer since September 2001. Previously, Mr. Cahill served as our President and Chief Operating Officer.

^{2,3} **Barry H. Beracha**, 63, was elected to PBG's Board in March 1999. Prior to his retirement in June 2003, Mr. Beracha most recently served as an Executive Vice President of Sara Lee Corporation, and Chief Executive Officer of Sara Lee Bakery Group since August 2001.

Rogelio Rebolledo, 60, was elected to PBG's Board in May 2004. Mr. Rebolledo has been the President and Chief Executive Officer of PBG Mexico since January 2004. From 2000 to 2003, Mr. Rebolledo was President and Chief Executive Officer of Frito-Lay International, a subsidiary of PepsiCo, Inc., operating in Latin America, Asia Pacific, Australia, Europe, the Middle East and Africa.

^{2,3} **Blythe J. McGarvie**, 48, was elected to the Board in March 2002. Ms. McGarvie is President of Leadership for International Finance, a private consulting firm.

Margaret D. Moore, 57, was elected to PBG's Board in January 2001. Ms. Moore is Senior Vice President, Human Resources of PepsiCo, a position she assumed at the end of 1999.

Not Pictured:

^{1,3} **John A. Quelch**, 53, was elected to PBG's Board in January 2005. Mr. Quelch has been the Senior Associate Dean for International Development and Lincoln Filene Professor of Business Administration at Harvard Business School since 2001.

Committees:

- ¹ Nominating and Corporate Governance Committee
- ² Audit and Affiliated Transactions Committee
- ³ Compensation and Management Development Committee

Financial Review

Corporate Governance

PBG's corporate governance principles are designed to ensure that its directors, officers and employees act in the collective interest of all shareholders and with the highest degree of integrity.

Board of Directors – All board members serving on our Audit and Affiliated Transactions Committee, Compensation and Management Development Committee, Nominating and Corporate Governance Committee are independent directors. Two of our board members are employees of PepsiCo, however they do not serve on any of the above-mentioned committees.

Our Audit and Affiliated Transactions Committee is composed solely of financially literate directors, with one member of the committee qualified and designated to serve as a financial expert. The committee assists the PBG Board in its oversight of: the quality and integrity of the Company's financial statements, independent and internal auditors and compliance with legal and regulatory requirements.

The members of our Compensation and Management Development Committee have direct responsibility for annual and long-term executive compensation and oversee employee benefit programs.

The members of our Nominating and Corporate Governance Committee are responsible for overseeing the performance of the Board and PBG's corporate governance practices as well as identifying and recommending qualified potential members to the Board.

Independent Auditors – KPMG LLP, our independent auditor, reports directly to the Audit and Affiliated Transactions Committee, and is given free access to all financial records and related data, including the minutes of the meetings of the Board of Directors and its committees.

Code of Conduct – Our Code of Conduct was approved by our Board of Directors and explains the principles that define our Company. We have provided our Code of Conduct to every one of our employees, directors and officers and we hold them personally accountable for compliance with its principles.

Business Ethics Line – Our business ethics line provides a confidential way for PBG employees or other interested parties to raise issues or concerns to our Board of Directors without retribution. The Business Ethics Line is monitored by an independent third party, and is available to employees at all locations worldwide. In addition, we have established a process for shareholders to communicate directly with PBG's non-management directors regarding their concerns, including the integrity of our financial reporting process.

For more information on our corporate governance principles, please go to our website at www.pbg.com.

Table of Contents

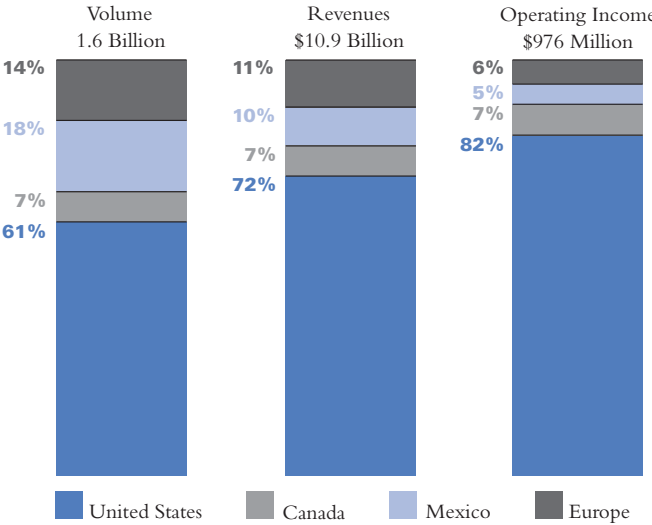
14	Management's Financial Review
33	Consolidated Statements of Operations
34	Consolidated Statements of Cash Flows
35	Consolidated Balance Sheets
36	Consolidated Statements of Changes in Shareholders' Equity
37	Notes to Consolidated Financial Statements
58	Report of Independent Registered Public Accounting Firm (regarding its audit of the Company's Consolidated Financial Statements)
58	Management's Report on Internal Control Over Financial Reporting
59	Report of Independent Registered Public Accounting Firm (regarding its audit of the Company's internal controls over financial reporting)
60	Selected Financial and Operating Data

Tabular dollars in millions, except per share data

Overview

The Pepsi Bottling Group, Inc. (“PBG” or the “Company”) is the world’s largest manufacturer, seller and distributor of Pepsi-Cola beverages. When used in these Consolidated Financial Statements, “PBG,” “we,” “our” and “us” each refers to The Pepsi Bottling Group, Inc. and, where appropriate, to Bottling Group, LLC, our principal operating subsidiary.

We have the exclusive right to manufacture, sell and distribute Pepsi-Cola beverages in all or a portion of the U.S., Mexico, Canada and Europe, which consists of operations in Spain, Greece, Russia and Turkey. As shown in the graph below, the U.S. business is the dominant driver of our results, generating 61% of our volume, 72% of our revenues and 82% of our operating income.



The brands we sell are some of the best recognized trade-marks in the world and include **PEPSI-COLA**, **DIET PEPSI**, **MOUNTAIN DEW**, **AQUAFINA**, **SIERRA MIST**, **DIET MOUNTAIN DEW**, **LIPTON BRISK**, **SOBE**, **STARBUCKS FRAPPUCCINO** and **TROPICANA JUICE DRINKS**, and outside the U.S., **PEPSI-COLA**, **7 UP**, **KAS**, **MIRINDA** and **AQUA MINERALE**. In some of our territories, we also have the right to manufacture, sell and distribute soft drink products of companies other than PepsiCo, Inc. (“PepsiCo”), including **DR PEPPER** and **SQUIRT** and trademarks we own including **ELECTROPURA**, **EPURA** and **GARCI CRESPO**.

Our products are sold in either a cold-drink or take-home format. Our cold-drink format consists of cold products sold in the retail and foodservice channels, which carry the highest profit margins on a per-case basis. Our take-home

format consists of unchilled products that are sold for at-home future consumption.

Physical cases represent the number of units that are actually produced, distributed and sold. Each case of product as sold to our customers, regardless of package configuration, represents one physical case. Our net price and gross margin on a per-case basis is impacted by how much we charge for the product, the mix of brands and packages we sell, and the channels in which the product is sold. For example, we realize a higher net revenue and gross margin per case on a 20-ounce chilled bottle sold in a convenience store than on a two-liter unchilled bottle sold in a grocery store.

Our financial success is dependent on a number of factors, including: our strong partnership with PepsiCo, the customer relationships we cultivate, pricing we achieve in the marketplace, our market execution and the efficiency we achieve in manufacturing and distributing our products. Key indicators of our financial success are measured by the number of physical cases we sell, the net price and gross margin we achieve on a per-case basis, and our overall cost productivity, reflecting how well we manage our raw material, manufacturing, distribution and other overhead costs.

The following discussion and analysis covers the key drivers behind our business performance in 2004 and is categorized into the following sections:

- FINANCIAL PERFORMANCE SUMMARY;
- CRITICAL ACCOUNTING POLICIES;
- RELATED PARTY TRANSACTIONS;
- ITEMS THAT AFFECT THE HISTORICAL OR FUTURE COMPARABILITY;
- RESULTS OF OPERATIONS;
- LIQUIDITY AND FINANCIAL CONDITION; and
- MARKET RISKS AND CAUTIONARY STATEMENTS.

The discussion and analysis throughout Management’s Financial Review should be read in conjunction with the Consolidated Financial Statements and the related accompanying notes. The preparation of our Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) requires us to make estimates and assumptions that affect the

reported amounts in our Consolidated Financial Statements and the related accompanying notes, including various claims and contingencies related to lawsuits, taxes, environmental and other matters arising out of the normal course of business. We use our best judgment, based on the advice of external experts and our knowledge of existing facts and circumstances and actions that we may undertake in the future, in determining the estimates that affect our Consolidated Financial Statements.

FINANCIAL PERFORMANCE SUMMARY

	52 Weeks Ended		
	December 25, 2004	December 27, 2003	% Change
Net revenues	\$10,906	\$10,265	6%
Gross profit	\$ 5,250	\$ 5,050	4%
Operating income	\$ 976	\$ 956	2%
Income before cumulative effect of change in accounting principle ⁽¹⁾	\$ 457	\$ 422	8%
Net income	\$ 457	\$ 416	10%
Diluted earnings per share ⁽²⁾	\$ 1.73	\$ 1.50	15%

(1) Cumulative effect of change in accounting principle for the fifty-two weeks ended December 27, 2003, reflects the impact of adoption of EITF Issue No. 02-16. See Note 2 – Summary of Significant Accounting Policies in the Notes to Consolidated Financial Statements for more information.

(2) 2003 diluted earnings per share include the following items:

	2003
Non-cash charge related to the adoption of EITF 02-16	\$(0.02)
Non-cash charge related to a Canadian tax law change (See Results of Operations)	\$(0.04)
Total	\$(0.06)

During 2004, we delivered solid results, reflecting strong topline growth which was partially offset by higher raw material costs and selling, delivery and administrative expenses. Overall, we grew our worldwide operating income by two percent, driven by a four percent increase in the U.S. and double-digit increases in Canada and Europe, partially offset by an operating income decline in Mexico of 40%. These results include a \$9 million non-cash impairment charge recorded in the fourth quarter related to our re-evaluation of the fair value of our franchise licensing agreement with Cadbury Bebidas, S.A. de C.V. for the **SQUIRT** trademark in Mexico, as a result of a change in its estimated accounting life.

Our strong topline growth was driven by innovation and solid execution in the marketplace. This growth has been

balanced, reflecting three percent growth in net revenue per case and two percent growth in volume, with the remaining percentage of growth coming from foreign currency translation. In the U.S., we achieved a two percent volume increase due primarily to the successful introduction of **TROPICANA JUICE DRINKS** and growth in **AQUAFINA** and our diet portfolio. In Europe, we delivered strong results, growing net revenues by 19 percent versus the prior year, driven by double-digit volume growth in Russia and Turkey. In Canada, **TROPICANA TWISTER** was introduced in 2004, and was a key player in the growth of non-carbonated drinks in that geography. Our product portfolio and packaging has been well positioned to capture the opportunity presented by changing consumer preferences geared toward health and wellness, variety and convenience.

Our strong topline growth was partially offset by increases in cost of sales, which have continued to pressure our bottom line results. On a per-case basis, cost of sales increased five percent, reflecting significant increases in raw material costs coupled with mix shifts into more expensive products and packages. During 2004, we have experienced increases in concentrate prices, coupled with growth in aluminum, sweeteners and resin prices, which added more than \$80 million of costs or one and a half percentage points of growth to our worldwide cost of sales per case. Additionally, the negative impact of foreign currency translation contributed one percentage point of growth to our cost of sales increase.

Selling, delivery and administrative expenses increased four percent, which includes one percentage point of growth from foreign currency. The remaining three percentage points of growth were due primarily to higher labor and benefit costs. These increases were partially offset by cost savings driven from a number of worldwide productivity initiatives we put in place during 2004 and a reduction in our bad debt expense.

In Mexico, we faced a number of challenges throughout the year including competitive pressures, increased commodity costs and the devaluation of the Mexican peso. Low-priced bargain brands continue to be an important factor in the marketplace, which has made it difficult for us and all soft drink suppliers to increase pricing. Cost of sales in Mexico has also been impacted by rising sweetener costs throughout the year and a steep rise in resin costs in the fourth quarter. We have made a number of investments in the marketplace and in our infrastructure in Mexico, which should provide long-term benefits, particularly in our water business and in

Management’s Financial Review

our operating efficiency. Trends are improving in Mexico, with volume increasing by four percent in the second half of the year, bringing our volume to flat for the full year. Innovation and execution in the marketplace played a key role in our volume improvement during the year. During 2004, we introduced a number of new products and packages, added 13,000 new accounts to our customer base and placed 24,000 net new coolers.

From a cash flow perspective, we continued our strong track record of growing our cash from operations. We generated \$1.3 billion of cash from operations, after contributing \$83 million into our pension plans, which are solidly funded. With our strong cash flows, we utilized \$717 million for capital investments to grow our business and returned \$613 million to our shareholders through share repurchases and dividends during the year. During 2004, we increased our annual dividend, raising it from \$0.04 to \$0.20 per share.

Outlook

In 2005, our fiscal year will include a 53rd week, while fiscal year 2004 consisted of 52 weeks. Our U.S. and Canadian operations report on a fiscal year that consists of 52 weeks, ending on the last Saturday in December. Every five or six years a 53rd week is added. Our other countries report on a calendar-year basis. In order to provide comparable guidance for 2005, we have excluded the impact of the 53rd week from our outlook. The table and the 2005 outlook discussion below provide pro forma disclosure by excluding the projected impact of the 53rd week in 2005:

	Pro Forma Forecasted 2005 vs. 2004 Growth	Impact of 53rd Week	Forecasted 2005 vs. 2004 Growth
Worldwide Volume	2% to 3%	1%	3% to 4%
U.S. and Canada Volume	Flat to 1%	1%	1% to 2%
Worldwide SD&A <i>(in dollars)</i>	2% to 3%	1%	3% to 4%
Worldwide Operating Profit <i>(in dollars)</i>	Flat to 3%	1%	1% to 4%

	Pro Forma Full-Year Forecasted 2005 Results	Impact of 53rd Week	Full-Year Forecasted 2005 Results
Interest Expense, net <i>(in millions)</i>	\$240 to \$245	≈\$4	\$244 to \$249
Diluted Earnings Per Share	\$1.76 to \$1.84	\$0.02 to \$0.03	\$1.78 to \$1.87

In 2005, we expect our pro forma worldwide volume to grow between two and three percent, with the U.S. and Canada each expected to be flat to up one percent, Mexico up three to four percent and Europe up mid to high-single digits. We will carefully balance our net revenue per case, using rate increases where marketplace conditions allow, while also managing the mix of products we plan to sell. We expect to increase our worldwide net revenue per case one to two percent, which reflects a three percent increase in the U.S., partially offset by larger contributions from our international territories that typically have lower net revenue per case than the U.S., coupled with an expected mid-single digit decline in the value of the Mexican peso.

In 2005, worldwide cost of sales per case is expected to increase by four to five percent. We are expecting the prices of resin, sweetener and aluminum to continue to increase, driving higher costs in excess of \$100 million during 2005 versus the prior year. As a result, we expect our gross margin per case growth to be flat. Our pro forma selling, delivery and administrative expenses are expected to rise two to three percent, reflecting increases in labor and benefits, partially offset by productivity initiatives in the U.S. and Mexico. Due to the increasing costs of our business, we expect pro forma operating income growth to be flat to up three percent. In 2005, we expect pro forma interest expense to increase to approximately \$240 million to \$245 million, reflecting the impact of the rising interest rates on approximately 20% of our debt that is variable.

We expect to deliver a pro forma diluted earnings per share of \$1.76 to \$1.84, excluding the impact of the 53rd week. We are considering reinvestment of the additional profit from the 53rd week in long-term strategic initiatives. Our 2005 outlook does not reflect the effect of the implementation of the final accounting standard on the expensing of share-based payments, which will have a material impact on our results. We are in the process of evaluating the impact of the standard. See Note 2 in Notes to Consolidated Financial Statements for more information. Additionally, the American Jobs Creation Act of 2004 was enacted allowing for special tax breaks for the repatriation of earnings from foreign subsidiaries. We are evaluating whether to repatriate our undistributed foreign earnings in 2005.

From a cash flow perspective, we expect to generate net cash provided by operations of about \$1.2 billion and we plan to spend between \$675 million and \$725 million in capital investments. Our cash flows from operations in 2005 are

expected to decline versus 2004 due to the expiration of legislated tax incentives. During 2005, two U.S. tax stimulus packages will expire, which allowed for accelerated tax deductions. Additionally, due to improved performance during 2004, we will be paying out higher incentive compensation in 2005, which will also drive some year-over-year unfavorability.

CRITICAL ACCOUNTING POLICIES

Allowance for Doubtful Accounts – A portion of our accounts receivable will not be collected due to customer disputes, bankruptcies and sales returns. Estimating an allowance for doubtful accounts requires significant management judgment and is dependent upon the overall economic environment and our customers’ viability. We provide reserves for these situations based on the evaluation of the aging of our trade receivable portfolio and an in-depth analysis of our high-risk customers. Our reserves contemplate our historical loss rate on receivables, specific customer situations and the economic environments in which we operate. We have effective credit controls in place to manage these exposures and believe that our allowance for doubtful accounts adequately provides for these risks.

Our allowance for doubtful accounts was \$61 million, \$72 million and \$67 million as of December 25, 2004, December 27, 2003 and December 28, 2002, respectively. Our allowance for doubtful accounts represents management’s best estimate of probable losses inherent in our portfolio. The following is an analysis of the allowance for doubtful accounts for the fiscal years ended December 25, 2004, December 27, 2003 and December 28, 2002:

	Allowance for Doubtful Accounts		
	2004	2003	2002
Beginning of the year	\$72	\$67	\$ 42
Bad debt expense	(5)	12	32
Additions from acquisitions	–	–	14
Accounts written off	(7)	(8)	(22)
Foreign currency translation	1	1	1
End of the year	\$61	\$72	\$ 67

Recoverability of Goodwill and Intangible Assets

with Indefinite Lives – Goodwill and intangible assets with indefinite useful lives are not amortized, but instead tested annually for impairment.

Our identified intangible assets principally arise from the allocation of the purchase price of businesses acquired, and consist primarily of franchise rights, distribution rights and brands. We assign amounts to such identified intangibles based on their estimated fair values at the date of acquisition. The determination of the expected life will be dependent upon the use and underlying characteristics of the identified intangible asset. In determining whether our intangible assets have an indefinite useful life, we consider the following as applicable: the nature and terms of underlying agreements; our intent and ability to use the specific asset contained in an agreement; the age and market position of the products within the territories we are entitled to sell; the historical and projected growth of those products; and costs, if any, to renew the agreement.

We evaluate our identified intangible assets with indefinite useful lives for impairment annually (unless it is required more frequently because of a triggering event) on an individual basis or by asset groups on a country-by-country basis, depending on the nature of the intangible asset. We measure impairment as the amount by which the carrying value exceeds its estimated fair value.

The fair value of our franchise rights and distribution rights is measured using a multi-period excess earnings method that is based upon estimated discounted future cash flows, including a terminal value, which assumes the franchise rights and distribution rights will continue in perpetuity. We deduct a contributory charge from our net after-tax cash flows for the economic return attributable to our working capital, other intangible assets and property, plant and equipment, which represents the required cash flow to support these assets. The net discounted cash flows in excess of the fair returns on these assets represent the estimated fair value of our franchise rights and distribution rights.

The fair value of our brands is measured using a multi-period royalty saving method, which reflects the savings realized by owning the brand and, therefore, not having to pay a royalty fee to a third party. In valuing our brands, we have selected an estimated industry royalty rate relating to each brand and then applied it to the forecasted revenues associated with each brand. The net discounted after-tax cash flows from these royalty charges represent the fair value of our brands.

Management’s Financial Review

Our discount rate utilized in each fair value calculation is based upon our weighted-average cost of capital plus an additional risk premium to reflect the risk and uncertainty inherent in separately acquiring the identified intangible asset between a willing buyer and a willing seller. The additional risk premium associated with our discount rate effectively eliminates the benefit that we believe results from synergies, scale and our assembled workforce, all of which are components of goodwill. Each year we re-evaluate our assumptions in our discounted cash flow model to address changes in our business and marketplace conditions.

We evaluate goodwill on a country-by-country basis (“reporting unit”) for impairment. We evaluate each reporting unit for impairment based upon a two-step approach. First, we compare the fair value of our reporting unit with its carrying value. Second, if the carrying value of our reporting unit exceeds its fair value, we compare the implied fair value of the reporting unit’s goodwill to its carrying amount to measure the amount of impairment loss. In measuring the implied fair value of goodwill, we would allocate the fair value of the reporting unit to each of its assets and liabilities (including any unrecognized intangible assets). Any excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill.

We measure the fair value of a reporting unit as the discounted estimated future cash flows, including a terminal value, which assumes the business continues in perpetuity, less its respective minority interest and net debt (net of cash and cash equivalents). Our long-term terminal growth assumptions reflect our current long-term view of the marketplace. Our discount rate is based upon our weighted-average cost of capital for each reporting unit. Each year we re-evaluate our assumptions in our discounted cash flow model to address changes in our business and marketplace conditions.

Considerable management judgment is necessary to estimate discounted future cash flows in conducting an impairment test for goodwill and other identified intangible assets, which may be impacted by future actions taken by us and our competitors and the volatility in the markets in which we conduct business. A change in assumptions in our cash flows could have a significant impact on the fair value of our reporting units and other identified intangible assets, which could then result in a material impairment charge to our results of operations.

Pension and Postretirement Medical Benefit Plans –

We sponsor pension and other postretirement medical benefit plans in various forms, covering employees who meet specified eligibility requirements. We account for our defined benefit pension plans and our postretirement medical benefit plans using actuarial models required by SFAS No. 87, “Employers’ Accounting for Pensions,” and SFAS No. 106, “Employers’ Accounting for Postretirement Benefits Other Than Pensions.” The amounts necessary to fund future payouts under these plans are subject to numerous assumptions and variables including anticipated discount rate, expected rate of return on plan assets, historical health care cost trends and future compensation levels. We evaluate these assumptions with our actuarial advisors on an annual basis and we believe that they are appropriate, although an increase or decrease in the assumptions or economic events outside our control could have a material impact on reported net income.

The assets, liabilities and assumptions used to measure pension and postretirement medical expense for any fiscal year are determined as of September 30 of the preceding year (“measurement date”). The discount rate assumption used in our pension and postretirement medical benefit plans’ accounting is based on current interest rates for high-quality, long-term corporate debt as determined on each measurement date. In evaluating our rate of return on assets for a given fiscal year, we consider the 10–15 year historical return of our pension investment portfolio, reflecting the weighted return of our asset allocation. Over the past three fiscal years, the composition of our pension assets in the U.S. was approximately 70%–75% equity investments and 25%–30% fixed income securities, which primarily consist of U.S. government and corporate bonds. Differences between actual and expected returns are generally recognized in the net periodic pension calculation over five years. To the extent the amount of all unrecognized gains and losses exceeds 10% of the larger of the benefit obligation or plan assets, such amount is amortized over the average remaining service life of active participants. The rate of future compensation increases is based upon our historical experience and management’s best estimate regarding future expectations. We amortize prior service costs on a straight-line basis over the average remaining service period of employees expected to receive benefits.

We used the following weighted-average assumptions to compute our pension and postretirement medical expense in the United States:

Pension	2004	2003	2002
Discount rate	6.25%	6.75%	7.50%
Expected return on plan assets (net of administrative expenses)	8.50%	8.50%	9.50%
Rate of compensation increase	4.20%	4.34%	4.33%

Postretirement	2004	2003	2002
Discount rate	6.25%	6.75%	7.50%
Rate of compensation increase	4.20%	4.34%	4.33%
Health care cost trend rate	11.00%	12.00%	8.00%

During 2004, our Company sponsored defined benefit pension and postretirement medical expenses in the U.S. totaled \$88 million. In 2005, these expenses will increase by \$12 million to \$100 million due primarily to the following factors:

- A decrease in our weighted-average discount rate for our pension and postretirement medical expense from 6.25% to 6.15%, reflecting declines in the yields of long-term corporate bonds. This assumption change will increase our 2005 defined benefit pension and postretirement medical expense by approximately \$3 million.
- Changes in demographics assumptions, including mortality, and other plan changes will increase our 2005 defined benefit pension and postretirement medical expense by approximately \$5 million.
- Merging our long-term disability medical plan with our postretirement medical plan. In 2004, we amended our long-term disability medical plan to provide coverage for two years for participants becoming disabled after January 1, 2005. Participants currently receiving benefits will be grandfathered under the existing benefits program. The costs of \$4 million associated with these participants will be reclassified from our long-term disability medical plan to our postretirement medical plan beginning in 2005.

Casualty Insurance Costs – Due to the nature of our business, we require insurance coverage for certain casualty risks. In the United States we are self-insured for workers’ compensation and automobile risks for occurrences up to \$10 million, and product and general liability risks for occurrences up to

\$5 million. For losses exceeding these self-insurance thresholds, we purchase casualty insurance from a third-party provider.

Our liability for casualty costs of \$169 million and \$127 million as of December 25, 2004 and December 27, 2003, respectively, is estimated using individual case-based valuations and statistical analyses and is based upon historical experience, actuarial assumptions and professional judgment. We do not discount our loss expense reserves. These estimates are subject to the effects of trends in loss severity and frequency and are subject to a significant degree of inherent variability. We evaluate these estimates with our actuarial advisors periodically during the year and we believe that they are appropriate, although an increase or decrease in the estimates or events outside our control could have a material impact on reported net income. Accordingly, the ultimate settlement of these costs may vary significantly from the estimates included in our financial statements.

Income Taxes – Our effective tax rate is based on pre-tax income, statutory tax rates, tax regulations and tax planning strategies available to us in the various jurisdictions in which we operate. The tax bases of our assets and liabilities reflect our best estimate of the tax benefit and costs we expect to realize. We establish valuation allowances to reduce our deferred tax assets to an amount that will more likely than not be realized. A significant portion of deferred tax assets consists of net operating loss carryforwards. We have net operating loss carryforwards totaling \$1,362 million at December 25, 2004, which are available to reduce future taxes in the U.S., Spain, Greece, Russia, Turkey and Mexico. The majority of our net operating loss carryforwards is generated overseas, the largest of which is coming from our Mexican and Spanish operations due to the financing put in place when we purchased the business of Pepsi–Gemex, S.A. de C.V. Of these carryforwards, \$10 million expire in 2005 and \$1,352 million expire at various times between 2006 and 2024.

Significant management judgment is required in determining our effective tax rate and in evaluating our tax position. We establish reserves when, despite our belief that our tax return positions are supportable, we believe these positions may be challenged. We adjust these reserves as warranted by changing facts and circumstances. A change in our tax reserves could have a significant impact on our results of operations.

Management’s Financial Review

Under our tax separation agreement with PepsiCo, Inc., PepsiCo maintains full control and absolute discretion for any combined or consolidated tax filings for tax periods ended on or before our initial public offering that occurred in March 1999. However, PepsiCo may not settle any issue without our written consent, which consent cannot be unreasonably withheld. PepsiCo has contractually agreed to act in good faith with respect to all tax audit matters affecting us. In accordance with the tax separation agreement, we will bear our allocable share of any risk or upside resulting from the settlement of tax matters affecting us for these periods.

A number of years may elapse before a particular matter for which we have established a reserve is audited and finally resolved. The number of years for which we have audits that are open varies depending on the tax jurisdiction. The U.S. Internal Revenue Service is currently examining our and PepsiCo’s joint tax returns for 1998 through March 1999 and our tax returns for the balance of 1999 and 2000. While it is often difficult to predict the final outcome or the timing of the resolution, we believe that our reserves reflect the probable outcome of known tax contingencies. Favorable resolutions would be recognized as a reduction of our tax expense in the year of resolution. Unfavorable resolutions would be recognized as a reduction to our reserves, a cash outlay for settlement and a possible increase to our annual tax provision.

RELATED PARTY TRANSACTIONS

PepsiCo is considered a related party due to the nature of our franchise relationship and its ownership interest in our company. Over 80% of our volume is derived from the sale of brands from PepsiCo. At December 25, 2004, PepsiCo owned approximately 42.5% of our outstanding common stock and 100% of our outstanding class B common stock, together representing approximately 47.7% of the voting power of all classes of our voting stock. In addition, PepsiCo owns 6.8% of the equity of Bottling Group, LLC, our principal operating subsidiary. We fully consolidate the results of Bottling Group, LLC and present PepsiCo’s share as minority interest in our Consolidated Financial Statements.

Our business is conducted primarily under beverage agreements with PepsiCo, including a master bottling agreement, non-cola bottling agreement and a master syrup agreement. Additionally, under a shared services agreement, we obtain

various services from PepsiCo, which include services for information technology maintenance and the procurement of raw materials. We also provide services to PepsiCo, including facility and credit and collection support.

We review our annual marketing, advertising, management and financial plans each year with PepsiCo for its approval. If we fail to submit these plans, or if we fail to carry them out in all material respects, PepsiCo can terminate our beverage agreements. Because we depend on PepsiCo to provide us with concentrate, bottler incentives and various services, changes in our relationship with PepsiCo could have a material adverse effect on our business and financial results.

Bottler Incentives and Other Arrangements – In order to promote PepsiCo beverages, PepsiCo, at its discretion, provides us with various forms of bottler incentives. These incentives are mutually agreed upon between PepsiCo and us and cover a variety of initiatives, including direct marketplace support, capital equipment funding and advertising support. Based on the objectives of the programs and initiatives, we record bottler incentives as an adjustment to net revenues, cost of sales or selling, delivery and administrative expenses. Beginning in 2003, due to the adoption of Emerging Issues Task Force (“EITF”) Issue No. 02-16, “Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor,” we have changed our accounting methodology for the way we record certain bottler incentives. See Note 2 in Notes to Consolidated Financial Statements for a discussion on the change in classification of these bottler incentives in our Consolidated Statements of Operations. Bottler incentives received from PepsiCo, including media costs shared by PepsiCo, were \$626 million, \$646 million and \$560 million for 2004, 2003 and 2002, respectively. Changes in our bottler incentives and funding levels could materially affect our business and financial results.

Purchase of Concentrate and Finished Product – As part of our franchise relationship, we purchase concentrate from PepsiCo, pay royalties and produce or distribute other products through various arrangements with PepsiCo or PepsiCo joint ventures. The prices we pay for concentrate, finished goods and royalties are determined by PepsiCo at its sole discretion. Significant changes in the amount we pay PepsiCo for concentrate, finished goods and royalties could materially affect our business and financial results. Total net amounts paid or payable to PepsiCo or PepsiCo joint ventures for

these arrangements were \$2,741 million, \$2,527 million and \$2,163 million in 2004, 2003 and 2002, respectively. These amounts are reflected in cost of sales in our Consolidated Statements of Operations.

Manufacturing and Distribution Service Reimbursements – In 2003 and 2002, we provided manufacturing services to PepsiCo and PepsiCo affiliates in connection with the production of certain finished beverage products. During 2003 and 2002, total amounts paid or payable by PepsiCo for these transactions were \$6 million and \$10 million, respectively.

Fountain Service Fee – We manufacture and distribute fountain products and provide fountain equipment service to PepsiCo customers in some territories in accordance with the Pepsi beverage agreements. Amounts received from PepsiCo for these transactions are offset by the cost to provide these services and are reflected in our Consolidated Statements of Operations in selling, delivery and administrative expenses. Net amounts paid or payable by PepsiCo to us for these services were approximately \$180 million, \$200 million and \$200 million, in 2004, 2003 and 2002, respectively.

Shared Services – We provide and receive various services from PepsiCo and PepsiCo affiliates pursuant to a shared services agreement and other arrangements. In the absence of these agreements, we would have to obtain such services on our own. We might not be able to obtain these services on terms, including cost, which are as favorable as those we receive from PepsiCo. Total expenses incurred with PepsiCo and PepsiCo affiliates were approximately \$68 million, \$72 million and, \$70 million during 2004, 2003 and 2002, respectively, and are reflected in selling, delivery and administrative expenses in our Consolidated Statements of Operations. Total income generated for services provided to PepsiCo and PepsiCo affiliates was approximately \$10 million, \$10 million, and \$13 million during 2004, 2003 and 2002, respectively, and is reflected in selling, delivery and administrative expenses in our Consolidated Statements of Operations.

Frito-Lay Purchases – We purchase snack food products from Frito-Lay, Inc., a subsidiary of PepsiCo, for sale and distribution in Russia. Amounts paid or payable to PepsiCo and its affiliates for snack food products were \$75 million, \$51 million and \$44 million in 2004, 2003 and 2002, respectively, and are reflected in selling, delivery and administrative expenses in our Consolidated Statements of Operations.

Income Tax Expense – Under tax sharing arrangements we have with PepsiCo, we recorded \$17 million, \$7 million and \$3 million in tax-related benefits from PepsiCo in 2004, 2003 and 2002, respectively.

The Consolidated Statements of Operations include the following income (expense) amounts as a result of transactions with PepsiCo and its affiliates:

	2004	2003	2002
Net revenues:			
Bottler incentives	\$ 22	\$ 21	\$ 257
Cost of sales:			
Purchases of concentrate and finished products, and AQUAFINA royalty fees	\$(2,741)	\$(2,527)	\$(2,163)
Bottler incentives	522	527	–
Manufacturing and distribution service reimbursements	–	6	10
	\$(2,219)	\$(1,994)	\$(2,153)
Selling, delivery and administrative expenses:			
Bottler incentives	\$ 82	\$ 98	\$ 303
Fountain service fee	180	200	200
Frito-Lay purchases	(75)	(51)	(44)
Shared services	(58)	(62)	(57)
	\$ 129	\$ 185	\$ 402
Income tax expense	\$ 17	\$ 7	\$ 3

For further information about our relationship with PepsiCo and its affiliates see Note 15 in Notes to Consolidated Financial Statements.

ITEMS THAT AFFECT HISTORICAL OR FUTURE COMPARABILITY

Gemex Acquisition – In November 2002, we acquired all of the outstanding capital stock of Pepsi-Gemex, S.A. de C.V. of Mexico (“Gemex”). Our total acquisition cost consisted of a net cash payment of \$871 million and assumed debt of approximately \$318 million.

Management’s Financial Review

The following unaudited pro forma operating information summarizes our consolidated results of operations as if the Gemex acquisition had occurred on the first day of fiscal year 2002.

	2002
Net revenues	\$10,297
Income before income taxes	\$ 676
Net income	\$ 446
Earnings per share	
Basic	\$ 1.58
Diluted	\$ 1.52

EITF Issue No. 02-16 – In January 2003, the Emerging Issues Task Force (“EITF”) reached a consensus on Issue No. 02-16, “Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor,” addressing the recognition and income statement classification of various cash consideration given by a vendor to a customer. The consensus requires that certain cash consideration received by a customer from a vendor is presumed to be a reduction of the price of the vendor’s products, and therefore should be characterized as a reduction of cost of sales when recognized in the customer’s income statement, unless certain criteria are met to overcome this presumption. EITF Issue No. 02-16 became effective beginning in our fiscal year 2003. Prior to 2003, we classified worldwide bottler incentives received from PepsiCo and other brand owners as adjustments to net revenues and selling, delivery and administrative expenses, depending on the objective of the program. In accordance with EITF Issue No. 02-16, we have classified certain bottler incentives as a reduction of cost of sales beginning in 2003.

See Note 2 in Notes to Consolidated Financial Statements, for additional information and pro forma adjustments for bottler incentives that would have been made to our reported results for the fifty-two weeks ended December 28, 2002 assuming that EITF Issue No. 02-16 had been in place for all periods presented.

Concentrate Supply – We buy concentrate, the critical flavor ingredient for our products, from PepsiCo, its affiliates and other brand owners who are the sole authorized suppliers. Concentrate prices are typically determined annually. PepsiCo determines concentrate prices at its sole discretion. In February 2004, PepsiCo increased the price of U.S. concentrate by 0.7%. PepsiCo has recently announced a further increase of approximately 2%, effective February 2005.

RESULTS OF OPERATIONS – 2004

Volume

	52 Weeks Ended		
	December 25, 2004 vs. December 27, 2003		
	World- wide	U.S.	Outside the U.S.
Base volume	2%	2%	3%
Acquisitions	1%	0%	1%
Total Volume Change	3%	2%	4%

Our full-year reported worldwide physical case volume increased three percent in 2004 versus 2003. Worldwide volume growth reflects increases in the U.S., Europe and Canada, partially offset by a flat performance in Mexico.

In the U.S., volume increased by two percent in 2004 versus 2003, driven by a four percent increase in our cold-drink channel and a one percent increase in our take-home channel. During 2004, we had solid results in our convenience and gas segment and foodservice business segment, which consists of our on-premise and full-service vending account customers. From a brand perspective, Trademark **PEPSI**’s volume was down one percent for the year, due to declines in brand **PEPSI** and **PEPSI TWIST**, partially offset by solid growth from our diet portfolio. Our non-carbonated soft drink portfolio increased 11% for the full year led by the introduction of **TROPICANA JUICE DRINKS** and continued growth from **AQUAFINA**.

In Europe, volume grew ten percent in 2004 versus 2003, driven by double-digit increases in Russia and Turkey. In Russia, we had solid growth in our core brands, coupled with contributions from new product introductions, including **TROPICANA JUICE** and **LIPTON ICED TEA**. In Turkey, we continue to improve in the areas of execution and distribution, which resulted in volume increases in brand **PEPSI**, **AQUAFINA** and local brands.

Total volume in Mexico, excluding the impact of acquisitions, was flat for the year. Volume trends in Mexico improved during the second half of the year, increasing four percent versus the prior year. Improvement in the second half of the year reflected improved marketplace execution, brand and package innovation

and our focus on consumer value. During the second half of the year, we saw increases in each of our jug, bottled water and carbonated soft drink categories. Increases in the second half of the year were offset by volume declines in the first half of the year driven primarily by our jug water business.

Net Revenues

	52 Weeks Ended		
	December 25, 2004 vs. December 27, 2003		
	World- wide	U.S.	Outside the U.S.
Volume impact	2%	2%	3%
Net price per case impact (rate/mix)	3%	3%	1%
Acquisitions	0%	0%	1%
Currency translation	1%	0%	3%
Total Net Revenues Change	6%	5%	8%

Worldwide net revenues were \$10.9 billion in 2004, a six percent increase over the prior year. The increase in net revenues for the year was driven by improvements in volume, growth in net price per case and the favorable impact from currency translation.

In the U.S., net revenues increased five percent in 2004 versus 2003. The increases in net revenues in the U.S. were driven by growth in both volume and net price per case. Increases in net price per case in the U.S. were due to a combination of rate increases, primarily in cans, and mix benefits from the sale of higher-priced products.

Net revenues outside the U.S. grew approximately eight percent in 2004 versus 2003. The increases in net revenues outside the U.S. were driven primarily by growth in volume and net price per case in Europe and Canada, coupled with the favorable impact of foreign exchange. This growth was partially offset by net revenue declines in Mexico. Net revenues in Mexico declined three percent on a full-year basis due primarily to the devaluation of the Mexican peso. In local currency, our net price per case in Mexico in 2004 was flat versus the prior year.

Cost of Sales

	52 Weeks Ended		
	December 25, 2004 vs. December 27, 2003		
	World- wide	U.S.	Outside the U.S.
Volume impact	2%	2%	3%
Cost per case impact	5%	5%	4%
Acquisitions	0%	0%	1%
Currency translation	1%	0%	3%
Total Cost of Sales Change	8%	7%	11%

Worldwide cost of sales was \$5.7 billion in 2004, an eight percent increase over 2003. The growth in cost of sales per case was driven primarily by significant increases in raw material costs, coupled with mix shifts into more expensive products and packages and the negative impact of foreign currency translation.

In the U.S., cost of sales grew seven percent in 2004 versus 2003, due to volume growth and increases in cost per case. The increases in cost per case resulted from higher commodity costs, primarily driven by aluminum and resin, coupled with the impact of mix shifts into more expensive products and packages.

Cost of sales outside the U.S. grew approximately eleven percent in 2004 versus 2003, reflecting increases in cost per case and volume, coupled with the negative impact from foreign currency translation. Growth in cost per case was driven by increases in Europe and Mexico. In Europe, we have experienced higher sweetener costs in Turkey and mix shifts into more expensive products in Russia. In Mexico, sweetener costs have increased throughout the year, coupled with a steep rise in resin costs in the fourth quarter. Foreign currency translation contributed three percentage points of growth, reflecting the appreciation of the euro and Canadian dollar, partially offset by the devaluation of the Mexican peso.

Management’s Financial Review

Selling, Delivery and Administrative Expenses

52 Weeks Ended			
December 25, 2004 vs. December 27, 2003			
	World- wide	U.S.	Outside the U.S.
Cost impact	3%	4%	3%
Acquisitions	0%	0%	1%
Currency translation	1%	0%	2%
Total SD&A Change	4%	4%	6%

Worldwide selling, delivery and administrative expenses were \$4.3 billion, a four percent increase over 2003. Increases in selling, delivery and administrative costs were driven by higher operating costs in the U.S. and Europe coupled with the negative impact of foreign currency translation.

In the U.S., increases reflect higher labor and benefit costs. These increases were partially offset by reduced operating costs driven from a number of productivity initiatives we put in place during 2004, coupled with a reduction in our bad debt expense.

Outside the U.S., increases were driven primarily by higher operating costs in Russia and Turkey and the negative impact of foreign currency throughout Europe and Canada. These increases were partially offset by declines in Mexico due to the devaluation of the Mexican peso and reduced operating costs. We have consolidated a number of warehouses and distribution systems in Mexico and are starting to capitalize on productivity gains and reduced costs. These results also include a \$9 million non-cash impairment charge that is related to our re-evaluation of the fair value of our franchise licensing agreement for the **SQUIRT** trademark in Mexico, as a result of a change in its estimated accounting life. See Note 6 in Notes to Consolidated Financial Statements for additional information.

Interest Expense, net

Interest expense, net decreased by \$9 million to \$230 million, when compared with 2003, largely due to lower effective interest rates achieved on our long-term debt.

Minority Interest

Minority interest represents PepsiCo’s approximate 6.8% ownership in our principal operating subsidiary, Bottling Group, LLC.

Income Tax Expense

Our effective tax rate for 2004 and 2003 was 33.7% and 36.3%, respectively. The decrease in our effective tax rate versus the prior year is due largely to the lapping of an \$11 million (\$0.04 per diluted share) tax charge relating to a Canadian tax law change in the fourth quarter of 2003. In 2004, we had the following significant tax items, which decreased our tax expense by approximately \$4 million:

- Tax reserves – During 2004, we adjusted previously established liabilities for tax exposures due largely to the settlement of certain international tax audits. The adjustment of these liabilities resulted in an \$8 million (or \$0.02 per diluted share) tax benefit for the year.
- International tax structure change – In December 2004, we initiated a reorganization of our international tax structure to allow for more efficient cash mobilization and to reduce potential future tax costs. This reorganization triggered a \$30 million tax charge (\$0.11 per diluted share) in the fourth quarter.

- Mexico tax rate change – In December 2004, legislation was enacted changing the Mexican statutory income tax rate. This rate change decreased our net deferred tax liabilities and resulted in a \$26 million (\$0.09 per diluted share) tax benefit in the fourth quarter.

Earnings Per Share

<i>Shares in millions</i>	2004	2003	2002
Basic earnings per share on reported net income	\$1.79	\$1.54	\$1.52
Basic weighted-average shares outstanding	255	270	282
Diluted earnings per share on reported net income	\$1.73	\$1.50	\$1.46
Diluted weighted-average shares outstanding	263	277	293

Dilution

Diluted earnings per share reflects the potential dilution that could occur if equity awards from our stock compensation plans were exercised and converted into common stock that would then participate in net income. Our employee equity award issuances have resulted in \$0.06, \$0.04 and \$0.06 per share of dilution in 2004, 2003 and 2002, respectively.

Diluted Weighted-Average Shares Outstanding

The decrease in shares outstanding reflects the effect of our share repurchase program, which began in October 1999, partially offset by share issuances from the exercise of stock options. The amount of shares authorized by the Board of Directors to be repurchased totals 100 million shares, of which we have repurchased approximately 21 million shares in 2004 and 84 million shares since the inception of our share repurchase program.

RESULTS OF OPERATIONS – 2003

Volume

52 Weeks Ended			
December 27, 2003 vs. December 28, 2002			
	World- wide	U.S.	Outside the U.S.
Acquisitions	20%	0%	74%
Base business	0%	(2)%	4%
Total Volume Change	20%	(2)%	78%

Our full-year reported worldwide physical case volume increased 20% in 2003 versus 2002. The increase in reported worldwide volume was due entirely to our acquisitions. Our acquisition of Gemex contributed more than 90% of the growth resulting from acquisitions.

In the U.S., our base business volume decreased 2% versus 2002 due to changes in consumer preferences, declines in our cold-drink business and weakness in retail traffic. (The term “base business” reflects territories that we owned and operated for comparable periods in both the current year and the prior year.) However, during the second half of 2003, we saw improvement in our cold-drink business as we began to implement changes to ensure that we have the right consumer value and the right space allocation for our products in the cold vaults. From a brand perspective, as consumers sought more variety, we saw declines in brand **PEPSI**, partially offset by strong growth in **AQUAFINA** and lemon-lime volume, led by **SIERRA MIST**, coupled with product introductions such as **PEPSI VANILLA** and **MOUNTAIN DEW LIVEWIRE**.

Outside the U.S., our base business volume increased by 4%. The increase in base business volume outside the U.S. was driven by warm summer weather in Europe, coupled with a strong performance in Russia, resulting from growth in **AQUA MINERALE** and the launch of **PEPSI X**.

Net Revenues

52 Weeks Ended			
December 27, 2003 vs. December 28, 2002			
	World- wide	U.S.	Outside the U.S.
Acquisitions	11%	1%	61%
Base business:			
EITF Issue No. 02-16 impact	(3)%	(3)%	(4)%
Currency translation	2%	0%	10%
Rate/mix impact (pricing)	1%	2%	3%
Volume impact	0%	(2)%	4%
Base business change	0%	(3)%	13%
Total Net Revenues Change	11%	(2)%	74%

Net revenues were \$10.3 billion in 2003, an 11% increase over the prior year. Approximately 72% of our net revenues was generated in the United States, 11% of our net revenues was generated in Mexico and the remaining 17% was generated outside the United States and Mexico. The increase in net revenues in 2003 was driven primarily by our acquisition of Gemex, which contributed more than 85% of the growth resulting from acquisitions. Our base business net revenues were flat in 2003 versus 2002. In 2003, base business net revenues were favorably impacted by foreign currency translation and price increases, offset by the reclassification of certain bottler incentives from net revenues to cost of sales resulting from the adoption of EITF Issue No. 02-16.

In the U.S., net revenues decreased 2% in 2003 versus 2002. The decrease in U.S. net revenues was due to a decline in volume and the impact of adopting EITF Issue No. 02-16. This was partially offset by a 2% increase in marketplace pricing and incremental revenue from acquisitions. Net revenues outside the U.S. grew approximately 74% in 2003

Management’s Financial Review

versus 2002. The increase in net revenues outside the U.S. was driven by our Gemex acquisition and an increase in our base business revenues of 13%. The increase in base business net revenues outside the U.S. was the result of favorable foreign currency translation in Canada and Europe, volume growth, and a 3% increase in pricing, partially offset by a decline due to the impact of adopting EITF Issue No. 02-16.

Cost of Sales

52 Weeks Ended			
December 27, 2003 vs. December 28, 2002			
	World- wide	U.S.	Outside the U.S.
Acquisitions	10%	1%	51%
Base business:			
EITF Issue No. 02-16 impact	(10)%	(9)%	(17)%
Cost per case impact	2%	3%	4%
Currency translation	2%	0%	8%
Volume impact	0%	(2)%	4%
Base business change	(6)%	(8)%	(1)%
Total Cost of Sales Change	4%	(7)%	50%

Cost of sales was \$5.2 billion in 2003, a 4% increase over 2002. The increase in cost of sales was due primarily to our acquisition of Gemex, which contributed more than 80% of the growth resulting from acquisitions, partially offset by a decline in our base business costs. The decline in base business cost of sales was due primarily to the reclassification of certain bottler incentives from net revenues and selling, delivery and administrative expenses to cost of sales resulting from the adoption of EITF Issue No. 02-16, partially offset by increases in cost per case and the negative impact of foreign currency translation.

In the U.S., cost of sales decreased 7% in 2003 versus 2002. The decrease in U.S. cost of sales was driven by volume declines and the impact of adopting EITF Issue No. 02-16, partially offset by cost per case increases and incremental costs from acquisitions. In the U.S., cost per case increased by 3% resulting from higher concentrate and resin costs, coupled with the mix of products we sell.

Our base business cost of sales outside the U.S. decreased approximately 1% in 2003 versus 2002. The decrease in base business cost of sales outside the U.S. was driven from the impact of adopting EITF Issue No. 02-16, partially offset by the negative impact of foreign currency translation in Canada and Europe, and increases in both cost per case and volume.

Selling, Delivery and Administrative Expenses

52 Weeks Ended			
December 27, 2003 vs. December 28, 2002			
	World- wide	U.S.	Outside the U.S.
Acquisitions	14%	1%	76%
Base business:			
EITF Issue No. 02-16 impact	6%	4%	18%
Currency translation	2%	0%	11%
Cost performance	1%	0%	4%
Base business change	9%	4%	33%
Total SD&A Change	23%	5%	109%

Selling, delivery and administrative expenses were \$4.1 billion in 2003, a 23% increase over 2002. The increase in selling, delivery and administrative expenses was driven primarily by our acquisition of Gemex and increases in our base business costs. Gemex contributed more than 90% of the growth resulting from acquisitions. The 9% increase in our base business selling, delivery and administrative expenses was due to the reclassification of certain bottler incentives from selling, delivery and administrative expenses to cost of sales resulting from the adoption of EITF Issue No. 02-16, coupled with the impact of foreign currency translation in Canada and Europe and an increase in our base business cost performance. Our base business cost performance increased 1% as a result of higher pension, employee benefit and casualty costs, partially offset by a reduction in our bad debt expense and productivity gains due to improvements in our operational efficiencies and selling execution to the marketplace.

Operating Income

Operating income was \$956 million in 2003, a 7% increase over 2002. The increase in operating income was due primarily to our acquisition of Gemex, partially offset by a 1% decrease in our base business. The decrease in our base business operating income resulted from increased selling, delivery and administrative expenses, partially offset by the improvement in the net impact of gross margin rate and mix in the U.S. and Europe, coupled with the favorable impact of foreign currency translation in Canada and Europe.

Interest Expense, Net

Interest expense, net increased by \$48 million to \$239 million, when compared with 2002, largely due to the additional interest associated with the \$1 billion 4.63% senior notes used to finance our acquisition of Gemex in November 2002 and the additional \$1.2 billion of debt issued during 2003. This was partially offset by the lower effective interest rate achieved on our fixed rate long-term debt from the use of interest rate swaps.

Minority Interest

Minority interest represents PepsiCo’s approximate 6.8% ownership in our principal operating subsidiary, Bottling Group, LLC.

Income Tax Expense Before Rate Change

Our full-year effective tax rate for 2003 was 34.4% before our income tax rate change expense. This rate corresponds to an effective tax rate of 34.0% in 2002. The increase in the effective tax rate is primarily due to the unfavorable mix in pre-tax income in jurisdictions with higher effective tax rates.

Income Tax Rate Change Expense (Benefit)

In December 2003, legislation was enacted changing certain Canadian provincial income tax rates. These rate changes increased deferred tax liabilities by \$11 million and resulted in a non-cash charge in 2003.

LIQUIDITY AND FINANCIAL CONDITION

Cash Flows

Fiscal 2004 Compared with Fiscal 2003

Net cash provided by operations grew by \$167 million to \$1,251 million in 2004. Increases in net cash provided by operations were driven by higher profits, lower pension contributions and working capital improvements, which include the lapping of a one-time payment in 2003 relating to the settlement of our New Jersey wage and hour litigation. These increases were partially offset by higher tax payments.

Net cash used for investments increased by \$57 million to \$791 million, principally reflecting higher capital spending, partially offset by higher proceeds from sales of property, plant and equipment.

Net cash used for financing increased by \$2,048 million to \$1,395 million driven primarily by the repayment of our \$1.0 billion note in February 2004, lower proceeds from long-term borrowings and higher share repurchases, partially offset by increased stock option exercises and higher short-term borrowings.

Fiscal 2003 Compared with Fiscal 2002

Our net cash provided by operations of \$1,084 million was driven by the strong cash flow generated from the sale of our products. Net operating cash flow grew by \$70 million over the prior year due primarily to the incremental cash generated by our Mexican business. This increase was partially offset by higher worldwide tax payments, U.S. casualty insurance payments and the settlement of our New Jersey wage and hour litigation.

Net cash used for investments decreased by \$1.0 billion to \$734 million, reflecting lower acquisition spending during 2003 and the lapping of a \$181 million investment in our debt defeasance trust in the prior year, partially offset by increases in capital expenditures.

Net cash provided by financing decreased by \$20 million to \$653 million, driven by higher share repurchases and lower stock option exercises, offset by an increase in our proceeds from long-term debt.

Liquidity and Capital Resources

We believe that our future cash flows from operations and borrowing capacity will be sufficient to fund capital expenditures, acquisitions, dividends and working capital requirements for the foreseeable future.

During the first quarter, we repaid our \$1 billion 5.38% senior notes with the proceeds we received from debt issued in the prior year.

In 2002, we purchased \$181 million in U.S. government securities and placed those securities into an irrevocable trust, for the sole purpose of funding payments of principal and interest on the \$160 million of 9.75% senior notes maturing in March 2004, in order to defease their respective covenants. In March 2004, we repaid our \$160 million of 9.75% senior notes by liquidating our investments in our debt defeasance trust.

We have a \$500 million commercial paper program in the U.S. that is supported by a credit facility, which is guaranteed by Bottling Group, LLC and expires in April 2009. At December 25, 2004, we had \$78 million in outstanding commercial paper with a weighted-average interest rate of 2.32%. At December 27, 2003, we had no outstanding commercial paper.

We had available short-term bank credit lines of approximately \$381 million and \$302 million at December 25, 2004 and December 27, 2003, respectively. These lines were used to support the general operating needs of our businesses outside the United States. As of year-end 2004, we had \$77 million outstanding under these lines of credit at a weighted-average interest rate of 3.72%. As of year-end 2003, we had \$67 million outstanding under these lines of credit at a weighted-average interest rate of 4.17%.

Certain of our senior notes have redemption features and non-financial covenants that will, among other things, limit our ability to create or assume liens, enter into sale and lease-back transactions, engage in mergers or consolidations and transfer or lease all or substantially all of our assets. Additionally, certain of our credit facilities and senior notes have financial covenants consisting of the following:

- Our debt to capitalization ratio should not be greater than .75 on the last day of a fiscal quarter when PepsiCo Inc.’s ratings are A- by S&P and A3 by Moody’s or higher. Debt is defined as total long-term and short-term debt plus accrued interest plus total standby letters of credit and other guarantees less cash and cash equivalents not in excess of \$500 million. Capitalization is defined as debt plus shareholders equity plus minority interest excluding the impact of the cumulative translation adjustment.
- Our debt to EBITDA ratio should not be greater than five on the last day of a fiscal quarter when PepsiCo Inc.’s ratings are less than A- by S&P or A3 by Moody’s. EBITDA is defined as the last four quarters of earnings before depreciation, amortization, net interest expense, income taxes, minority interest, net other non-operating expenses and extraordinary items.
- New secured debt should not be greater than 10% of Bottling Group, LLC’s net tangible assets. Net tangible assets are defined as total assets less current liabilities and net intangible assets.

We are in compliance with all debt covenants.

Our peak borrowing timeframe varies with our working capital requirements and the seasonality of our business. Additionally, throughout the year, we may have further short-term borrowing requirements driven by other operational needs of our business. During 2004, borrowings from our commercial paper program in the U.S. peaked at \$171 million. Outside the U.S., borrowings from our international credit facilities peaked at \$130 million, reflecting payments for working capital requirements.

Contractual Obligations

The following table summarizes our contractual obligations as of December 25, 2004:

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1–3 years	3–5 years	More than 5 years
Long-term debt obligations ⁽¹⁾	\$4,555	\$ 51	\$547	\$1,304	\$2,653
Capital lease obligations ⁽²⁾	6	2	1	1	2
Operating leases ⁽²⁾	222	45	68	43	66
Interest obligations ⁽³⁾	2,743	233	461	408	1,641
Purchase obligations:					
Raw material obligations ⁽⁴⁾	161	1	107	53	—
Capital expenditure obligations ⁽⁵⁾	48	48	—	—	—
Other obligations ⁽⁶⁾	292	178	62	30	22
Other long-term liabilities ⁽⁷⁾	31	6	13	7	5
Total	\$8,058	\$564	\$1,259	\$1,846	\$4,389

- (1) See Note 8 in Notes to Consolidated Financial Statements for additional information relating to our long-term debt obligations.
- (2) See Note 9 in Notes to Consolidated Financial Statements for additional information relating to our lease obligations.
- (3) Represents interest payment obligations related to our long-term fixed-rate debt as specified in the applicable debt agreements. Additionally, a portion of our long-term debt has variable interest rates due to either existing swap agreements or interest arrangements. We estimated our variable interest payment obligations by using the interest rate forward curve.
- (4) Represents obligations to purchase raw materials pursuant to contracts entered into by PepsiCo on our behalf.
- (5) Represents commitments to suppliers under capital expenditure related contracts or purchase orders.
- (6) Represents noncancellable agreements that specify fixed or minimum quantities, price arrangements and timing of payments. Also includes agreements that provide for termination penalty clauses.
- (7) Primarily relates to contractual obligations associated with non-compete contracts that resulted from business acquisitions. The table excludes other long-term liabilities included in our Consolidated Financial Statements, such as pension, postretirement and other non-contractual obligations. See Note 11 in Notes to Consolidated Financial Statements for a discussion of our future pension and postretirement contributions and corresponding expected benefit payments for years 2005 through 2014.

Off-Balance Sheet Arrangements

There are no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

Capital Expenditures

Our business requires substantial infrastructure investments to maintain our existing level of operations and to fund investments targeted at growing our business. Capital infrastructure expenditures totaled \$717 million, \$644 million and \$623 million during 2004, 2003 and 2002, respectively.

Acquisitions

During 2004, we acquired the operations and exclusive right to manufacture, sell and distribute Pepsi-Cola beverages from four franchise bottlers. The following acquisitions occurred for an aggregate purchase price of \$95 million in cash and assumption of liabilities of \$22 million:

- Gaseosas, S.A. de C.V. of Mexicali, Mexico in March
- Seltzer and Rydholm, Inc. of Auburn, Maine in October
- Phil Gaudreault et Fils Ltee of Quebec, Canada in November
- Bebidas Purificada, S.A. de C.V. of Juarez, Mexico in November

As a result of these acquisitions, we have assigned \$5 million to goodwill, \$66 million to franchise rights and \$3 million to non-compete arrangements. The goodwill and franchise rights are not subject to amortization. The non-compete agreements are being amortized over five to ten years. The allocations of the purchase price for these acquisitions are still preliminary and will be determined based on the estimated fair value of assets acquired and liabilities assumed as of the dates of acquisitions. The operating results of each of our acquisitions are included in the accompanying consolidated financial statements from its respective date of purchase. These acquisitions were made to enable us to provide better service to our large retail customers. We expect these acquisitions to reduce costs through economies of scale.

During 2004, we also paid \$1 million for the purchase of certain distribution rights relating to **SOBE**.

During 2003, we acquired the operations and exclusive right to manufacture, sell and distribute beverages from three franchise bottlers. The following acquisitions occurred for an aggregate purchase price of \$91 million in cash and the assumption of liabilities of \$13 million:

- Pepsi-Cola Buffalo Bottling Corp. of Buffalo, New York in February
- Cassidy’s Beverage Limited of New Brunswick, Canada in February
- Olean Bottling Works, Inc. of Olean, New York in August

During 2003, we also paid \$5 million for the purchase of certain distribution rights relating to **SOBE** and **DR PEPPER**. In addition, we paid \$4 million for purchase obligations relating to acquisitions made in the prior year.

We intend to continue to pursue other acquisitions of independent PepsiCo bottlers in the U.S., Mexico and Canada, particularly in territories contiguous to our own, where they create shareholder value. We also intend to continue to evaluate other international acquisition opportunities as they become available.

MARKET RISKS AND CAUTIONARY STATEMENTS
Quantitative and Qualitative Disclosures
about Market Risk

In the normal course of business, our financial position is routinely subject to a variety of risks. These risks include the risk associated with the price of commodities purchased and used in our business, interest rates on outstanding debt and currency movements of non-U.S. dollar denominated assets and liabilities. We are also subject to the risks associated with the business environment in which we operate, including the collectibility of accounts receivable. We regularly assess all of these risks and have policies and procedures in place to protect against the adverse effects of these exposures.

Our objective in managing our exposure to fluctuations in commodity prices, interest rates and foreign currency exchange rates is to minimize the volatility of earnings and cash flows associated with changes in the applicable rates and prices. To achieve this objective, we have derivative instruments to hedge against the risk of adverse movements in commodity prices, interest rates and foreign currency. Our corporate policy prohibits the use of derivative instruments for trading or speculative purposes, and we have procedures in place to monitor and control their use. See Note 10 in Notes to Consolidated Financial Statements for additional information relating to our derivative instruments.

A sensitivity analysis has been prepared to determine the effects that market risk exposures may have on the fair values of our debt and other financial instruments. To perform the sensitivity analysis, we assessed the risk of loss in fair values from the hypothetical changes in commodity prices, interest rates and foreign currency exchange rates on market-sensitive instruments. Information provided by this sensitivity analysis does not necessarily represent the actual changes in fair value that we would incur under normal market conditions because, due to practical limitations, all variables other than the specific market risk factor were held constant. In addition, the results of the analysis are constrained by the fact that certain items are specifically excluded from the analysis, while the financial instruments that relate to the financing or hedging of those items are included. As a result, the reported changes in the values of some financial instruments that affect the results of the sensitivity analysis are not matched with the offsetting changes in the values of the items that those instruments are designed to finance or hedge.

Commodity Price Risk

We are subject to market risks with respect to commodities because our ability to recover increased costs through higher pricing may be limited by the competitive environment in which we operate. We use futures contracts and options on futures in the normal course of business to hedge anticipated purchases of certain commodities used in our operations. With respect to commodity price risk, we currently have various contracts outstanding for commodity purchases in 2005, which establish our purchase prices within defined ranges. We estimate that a 10% decrease in commodity prices with all other variables held constant would have resulted in a decrease in the fair value of our financial instruments of \$10 million and \$17 million at December 25, 2004 and December 27, 2003, respectively.

Interest Rate Risk

The fair value of our fixed-rate long-term debt is sensitive to changes in interest rates. Interest rate changes would result in gains or losses in the fair market value of our debt, representing differences between market interest rates and the fixed-rate on the debt. As a result of the market risk, we effectively converted a portion of our fixed-rate debt to floating-rate debt through the use of interest rate swaps. We estimate that a 10% decrease in interest rates with all other variables held constant would have resulted in a net increase in the fair value of our financial instruments (which includes both our fixed-rate debt and our interest rate swaps) of \$149 million and \$160 million at December 25, 2004 and December 27, 2003, respectively.

Foreign Currency Exchange Rate Risk

In 2004, approximately 28% of our net revenues came from outside the United States. Social, economic and political conditions in these international markets may adversely affect our results of operations, cash flows and financial condition. The overall risks to our international businesses include changes in foreign governmental policies and other political or economic developments. These developments may lead to new product pricing, tax or other policies and monetary fluctuations that may adversely impact our business. In addition, our results of operations and the value of the foreign assets and liabilities are affected by fluctuations in foreign currency exchange rates.

As currency exchange rates change, translation of the statements of operations of our businesses outside the U.S. into U.S. dollars affects year-over-year comparability. We generally have not hedged against these types of currency risks because cash flows from our international operations are usually reinvested locally.

We have foreign currency transactional risks in certain of our international territories for transactions that are denominated in currencies that are different from their functional currency. Beginning in 2004, we have entered into forward exchange contracts to hedge portions of our forecasted U.S. dollar cash flows in our Canadian business. At December 25, 2004, a 10% weaker U.S. dollar against the Canadian dollar, with all other variables held constant, would result in a decrease in the fair value of our financial instruments of \$10 million. Conversely, a 10% stronger U.S. dollar against the Canadian dollar, with all other variables held constant, would result in an increase in the fair value of our financial instruments of \$9 million.

Foreign currency gains and losses reflect both transaction gains and losses in our foreign operations, as well as translation gains and losses arising from the re-measurement into U.S. dollars of the net monetary assets of businesses in highly inflationary countries. Turkey and Russia were considered highly inflationary economies for accounting purposes in 2002. Beginning in 2003, Russia was no longer considered highly inflationary, and as a result, changed its functional currency from the U.S. dollar to the Russian ruble. There was no material impact on our consolidated financial statements as a result of Russia’s change in functional currency. For 2004 and 2003, Turkey was still considered a highly inflationary economy for accounting purposes.

Unfunded Deferred Compensation Liability

Our unfunded deferred compensation liability is subject to changes in our stock price as well as price changes in certain other equity and fixed income investments. Employees participating in our deferred compensation program can elect to defer all or a portion of their compensation to be paid out on a future date or dates. As part of the deferral process, employees select from phantom investment options that determine the earnings on the deferred compensation liability and the amount that they will ultimately receive. Employee investment elections include PBG stock and a variety of other equity and fixed-income investment options.

Management’s Financial Review

Since the plan is unfunded, employees’ deferred compensation amounts are not directly invested in these investment vehicles. Instead, we track the performance of each employee’s investment selections and adjust his or her deferred compensation account accordingly. The adjustments to the employees’ accounts increase or decrease the deferred compensation liability reflected on our Consolidated Balance Sheets with an offsetting increase or decrease to our selling, delivery and administrative expenses.

We use prepaid forward contracts to hedge the portion of our deferred compensation liability that is based on our stock price. Therefore, changes in compensation expense as a result of changes in our stock price are substantially offset by the changes in the fair value of these contracts. We estimate that a 10% unfavorable change in the year-end stock price would have reduced the fair value from these commitments by \$2 million in 2004 and 2003.

Cautionary Statements

Except for the historical information and discussions contained herein, statements contained in this annual report on Form 10-K and in the annual report to the shareholders may constitute forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on currently available competitive, financial and economic data and our operating plans. These statements involve a number of risks, uncertainties and other factors that could cause actual results to be materially different. Among the events and uncertainties that could adversely affect future periods are:

- changes in our relationship with PepsiCo that could have a material adverse effect on our long-term and short-term business and financial results;
- restrictions imposed by PepsiCo on our raw material suppliers that could increase our costs;
- material changes from expectations in the cost of raw materials and ingredients;
- decreased demand for our product resulting from changes in consumers’ preferences;

- an inability to achieve volume growth through product and packaging initiatives;
- impact of competitive activities on our business;
- impact of customer consolidations on our business;
- an inability to achieve cost savings;
- material changes in capital investment for infrastructure and an inability to achieve the expected timing for returns on cold-drink equipment and related infrastructure expenditures;
- material changes in expected levels of bottler incentive payments from PepsiCo;
- changes in product category consumption;
- unfavorable weather conditions in our markets;
- unforeseen economic and political changes;
- possible recalls of our products;
- an inability to meet projections for performance in newly acquired territories;
- failure or inability to comply with laws and regulations;
- changes in laws and regulations governing the manufacture and sale of food and beverages, including restrictions on the sale of carbonated soft drinks in schools;
- changes in laws and regulations governing the environment, transportation, employee safety, labor and government contracts;
- changes in accounting standards and taxation requirements (including unfavorable outcomes from audits performed by various tax authorities);
- changes in our debt ratings;
- material changes in expected interest and currency exchange rates and unfavorable market performance of our pension plan assets;
- interruptions of operations due to labor disagreements;
- loss of business from a significant customer; and
- limitations on the availability of water or obtaining water rights.

Consolidated Statements of Operations

Fiscal years ended December 25, 2004, December 27, 2003 and December 28, 2002			
<i>in millions, except per share data</i>	2004	2003	2002
Net Revenues	\$10,906	\$10,265	\$9,216
Cost of sales	5,656	5,215	5,001
Gross Profit	5,250	5,050	4,215
Selling, delivery and administrative expenses	4,274	4,094	3,317
Operating Income	976	956	898
Interest expense, net	230	239	191
Other non-operating expenses, net	1	7	7
Minority interest	56	50	51
Income Before Income Taxes	689	660	649
Income tax expense	232	238	221
Income Before Cumulative Effect of Change in Accounting Principle	457	422	428
Cumulative effect of change in accounting principle, net of tax and minority interest	–	6	–
Net Income	\$ 457	\$ 416	\$ 428
Basic Earnings Per Share Before Cumulative Effect of Change in Accounting Principle	\$ 1.79	\$ 1.56	\$ 1.52
Cumulative effect of change in accounting principle	–	0.02	–
Basic Earnings Per Share	\$ 1.79	\$ 1.54	\$ 1.52
Weighted-average shares outstanding	255	270	282
Diluted Earnings Per Share Before Cumulative Effect of Change in Accounting Principle	\$ 1.73	\$ 1.52	\$ 1.46
Cumulative effect of change in accounting principle	–	0.02	–
Diluted Earnings Per Share	\$ 1.73	\$ 1.50	\$ 1.46
Weighted-average shares outstanding	263	277	293

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

Fiscal years ended December 25, 2004, December 27, 2003 and December 28, 2002			
<i>in millions</i>	2004	2003	2002
Cash Flows – Operations			
Net income	\$ 457	\$ 416	\$ 428
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation	580	556	443
Amortization	13	12	8
Deferred income taxes	31	125	131
Cumulative effect of change in accounting principle	–	6	–
Other non–cash charges and credits, net	298	303	228
Changes in operating working capital, excluding effects of acquisitions:			
Accounts receivable, net	(41)	(20)	(19)
Inventories, net	(38)	4	13
Prepaid expenses and other current assets	(16)	7	(7)
Accounts payable and other current liabilities	92	(118)	(10)
Net change in operating working capital	(3)	(127)	(23)
Pension contributions	(83)	(162)	(151)
Other, net	(42)	(45)	(50)
Net Cash Provided by Operations	1,251	1,084	1,014
Cash Flows – Investments			
Capital expenditures	(717)	(644)	(623)
Acquisitions of bottlers	(96)	(100)	(936)
Sales of property, plant and equipment	22	10	6
Investment in debt defeasance trust	–	–	(181)
Net Cash Used for Investments	(791)	(734)	(1,734)
Cash Flows – Financing			
Short-term borrowings, net – three months or less	104	8	(78)
Net proceeds from issuances of long-term debt	23	1,141	1,031
Payments of long-term debt	(1,014)	(30)	(120)
Minority interest distribution	(13)	(7)	(11)
Dividends paid	(31)	(11)	(11)
Proceeds from exercise of stock options	118	35	93
Purchases of treasury stock	(582)	(483)	(231)
Net Cash (Used for) Provided by Financing	(1,395)	653	673
Effect of Exchange Rate Changes on Cash and Cash Equivalents	5	10	(8)
Net (Decrease) Increase in Cash and Cash Equivalents	(930)	1,013	(55)
Cash and Cash Equivalents – Beginning of Year	1,235	222	277
Cash and Cash Equivalents – End of Year	\$ 305	\$1,235	\$ 222

Supplemental Cash Flow Information

Non–Cash Investing and Financing Activities:

Liabilities incurred and/or assumed in conjunction with acquisitions of bottlers	\$ 20	\$ 146	\$ 813
--	--------------	--------	--------

See accompanying notes to Consolidated Financial Statements.

Consolidated Balance Sheets

December 25, 2004 and December 27, 2003		
<i>in millions, except per share data</i>	2004	2003
Assets		
Current Assets		
Cash and cash equivalents	\$ 305	\$ 1,235
Accounts receivable, less allowance of \$61 in 2004 and \$72 in 2003	1,054	994
Inventories	427	374
Prepaid expenses and other current assets	253	268
Investment in debt defeasance trust	–	168
Total Current Assets	2,039	3,039
Property, plant and equipment, net	3,581	3,423
Other intangible assets, net	3,639	3,562
Goodwill	1,416	1,386
Other assets	118	134
Total Assets	\$10,793	\$11,544
Liabilities and Shareholders’ Equity		
Current Liabilities		
Accounts payable and other current liabilities	\$ 1,373	\$ 1,231
Short-term borrowings	155	67
Current maturities of long-term debt	53	1,180
Total Current Liabilities	1,581	2,478
Long-term debt	4,489	4,493
Other liabilities	914	875
Deferred income taxes	1,415	1,421
Minority interest	445	396
Total Liabilities	8,844	9,663
Shareholders’ Equity		
Common stock, par value \$0.01 per share:		
authorized 900 shares, issued 310 shares	3	3
Additional paid-in capital	1,719	1,743
Retained earnings	1,887	1,471
Accumulated other comprehensive loss	(315)	(380)
Deferred compensation	(1)	(4)
Treasury stock: 61 shares and 49 shares in 2004 and 2003, respectively, at cost	(1,344)	(952)
Total Shareholders’ Equity	1,949	1,881
Total Liabilities and Shareholders’ Equity	\$10,793	\$11,544

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Shareholders’ Equity

Fiscal years ended December 25, 2004, December 27, 2003 and December 28, 2002

<i>in millions, except per share data</i>	Common Stock	Additional Paid-In Capital	Deferred Compen- sation	Retained Earnings	Accumu- lated Other Compre- hensive Loss	Treasury Stock	Total	Compre- hensive Income
Balance at December 29, 2001	\$3	\$1,739	\$—	\$ 649	\$ (370)	\$ (420)	\$ 1,601	
Comprehensive income:								
Net income	—	—	—	428	—	—	428	\$ 428
Net currency translation adjustment	—	—	—	—	18	—	18	18
Cash flow hedge adjustment (net of tax and minority interest of \$4)	—	—	—	—	7	—	7	7
Minimum pension liability adjustment (net of tax and minority interest of \$93)	—	—	—	—	(123)	—	(123)	(123)
Total comprehensive income								<u>\$ 330</u>
Stock option exercises: 8 shares	—	(31)	—	—	—	124	93	
Tax benefit – stock option exercises	—	42	—	—	—	—	42	
Purchase of treasury stock: 9 shares	—	—	—	—	—	(231)	(231)	
Cash dividends declared on common stock (per share: \$0.04)	—	—	—	(11)	—	—	(11)	
Balance at December 28, 2002	3	1,750	—	1,066	(468)	(527)	1,824	
Comprehensive income:								
Net income	—	—	—	416	—	—	416	\$ 416
Net currency translation adjustment	—	—	—	—	90	—	90	90
Cash flow hedge adjustment (net of tax and minority interest of \$13)	—	—	—	—	18	—	18	18
Minimum pension liability adjustment (net of tax and minority interest of \$14)	—	—	—	—	(20)	—	(20)	(20)
Total comprehensive income								<u>\$ 504</u>
Stock option exercises: 3 shares	—	(23)	—	—	—	58	35	
Tax benefit – stock option exercises	—	8	—	—	—	—	8	
Purchase of treasury stock: 23 shares	—	—	—	—	—	(483)	(483)	
Stock compensation	—	8	(4)	—	—	—	4	
Cash dividends declared on common stock (per share: \$0.04)	—	—	—	(11)	—	—	(11)	
Balance at December 27, 2003	3	1,743	(4)	1,471	(380)	(952)	1,881	
Comprehensive income:								
Net income	—	—	—	457	—	—	457	\$ 457
Net currency translation adjustment	—	—	—	—	84	—	84	84
Cash flow hedge adjustment (net of tax and minority interest of \$2)	—	—	—	—	(3)	—	(3)	(3)
Minimum pension liability adjustment (net of tax and minority interest of \$13)	—	—	—	—	(16)	—	(16)	(16)
Total comprehensive income								<u>\$ 522</u>
Stock option exercises: 9 shares	—	(72)	—	—	—	190	118	
Tax benefit – stock option exercises	—	51	—	—	—	—	51	
Purchase of treasury stock: 21 shares	—	—	—	—	—	(582)	(582)	
Stock compensation	—	(3)	3	—	—	—	—	
Cash dividends declared on common stock (per share: \$0.16)	—	—	—	(41)	—	—	(41)	
Balance at December 25, 2004	\$3	\$1,719	\$ (1)	\$1,887	\$ (315)	\$ (1,344)	\$1,949	

See accompanying notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Tabular dollars in millions, except per share data

NOTE 1 BASIS OF PRESENTATION

The Pepsi Bottling Group, Inc. (“PBG” or the “Company”) is the world’s largest manufacturer, seller and distributor of Pepsi-Cola beverages, consisting of bottling operations located in the United States, Mexico, Canada, Spain, Greece, Russia and Turkey. When used in these Consolidated Financial Statements, “PBG,” “we,” “our” and “us” each refers to The Pepsi Bottling Group, Inc. and, where appropriate, to Bottling Group, LLC, our principal operating subsidiary.

At December 25, 2004, PepsiCo, Inc. (“PepsiCo”) owned 106,011,358 shares of our common stock, consisting of 105,911,358 shares of common stock and 100,000 shares of Class B common stock. All shares of Class B common stock that have been authorized have been issued to PepsiCo. At December 25, 2004, PepsiCo owned approximately 42.5% of our outstanding common stock and 100% of our outstanding Class B common stock, together representing approximately 47.7% of the voting power of all classes of our voting stock. In addition, PepsiCo owns 6.8% of the equity of Bottling Group, LLC, our principal operating subsidiary. We fully consolidate the results of Bottling Group, LLC and present PepsiCo’s share as minority interest in our Consolidated Financial Statements.

The common stock and Class B common stock both have a par value of \$0.01 per share and are substantially identical, except for voting rights. Holders of our common stock are entitled to one vote per share and holders of our Class B common stock are entitled to 250 votes per share. Each share of Class B common stock is convertible into one share of common stock. Holders of our common stock and holders of our Class B common stock share equally on a per-share basis in any dividend distributions.

Our Board of Directors has the authority to issue up to 20,000,000 shares of preferred stock, and to determine the price and terms, including, but not limited to, preferences and voting rights of those shares without stockholder approval. At December 25, 2004, there was no preferred stock outstanding.

Certain reclassifications were made in our Consolidated Financial Statements to 2003 amounts to conform to the 2004 presentation.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) requires us to make estimates and assumptions that affect reported amounts of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities. Actual results could differ from these estimates. For additional unaudited information on certain accounting policies, see “Critical Accounting Policies” in Management’s Financial Review.

Basis of Consolidation – The accounts of all of our wholly and majority-owned subsidiaries are included in the accompanying Consolidated Financial Statements. We have eliminated intercompany accounts and transactions in consolidation.

Fiscal Year – Our U.S. and Canadian operations report using a fiscal year that consists of fifty-two weeks, ending on the last Saturday in December. Every five or six years a fifty-third week is added. Fiscal years 2004, 2003 and 2002 each consisted of fifty-two weeks. In 2005, our fiscal year will consist of fifty-three weeks (the additional week is added to the fourth quarter). Our remaining countries report using a calendar-year basis. Accordingly, we recognize our quarterly business results as outlined below:

Quarter	U.S. & Canada	Mexico & Europe
First Quarter	12 weeks	January and February
Second Quarter	12 weeks	March, April and May
Third Quarter	12 weeks	June, July and August
Fourth Quarter	16 weeks	September, October, November and December

Revenue Recognition – We recognize revenue when our products are delivered to customers. We offer certain sales incentives to our customers, which are accounted for as a reduction in our net revenues when the sales incentives are earned. A number of these arrangements are based upon annual and quarterly targets that generally do not exceed one year. Based upon forecasted volume and other performance criteria, net revenues are reduced by the expected amounts to be paid out to our customers.

Advertising and Marketing Costs – We are involved in a variety of programs to promote our products. We include advertising and marketing costs in selling, delivery and administrative

expenses and expense such costs during the fiscal year incurred, generally in proportion to revenue, based on annual targets. Advertising and marketing costs were \$426 million, \$453 million and \$441 million in 2004, 2003 and 2002, respectively, before bottler incentives received from PepsiCo and other brand owners.

Bottler Incentives – PepsiCo and other brand owners provide us with various forms of bottler incentives. These incentives are mutually agreed upon between us and PepsiCo and other brand owners and cover a variety of initiatives, including direct marketplace support, capital equipment funding and advertising support. Based on the objective of the programs and initiatives, we record bottler incentives as an adjustment to net revenues, cost of sales or selling, delivery and administrative expenses. Beginning in 2003, due to the adoption of Emerging Issues Task Force (“EITF”) Issue No. 02-16, “Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor,” we changed our accounting methodology for the way we record bottler incentives. Prior to 2003, we classified worldwide bottler incentives received from PepsiCo and other brand owners as adjustments to net revenues and selling, delivery and administrative expenses depending on the objective of the program. Beginning in 2003, we have classified bottler incentives as follows:

- Direct marketplace support represents PepsiCo’s and other brand owners’ agreed-upon funding to assist us in offering sales and promotional discounts to retailers and is generally recorded as an adjustment to cost of sales. If the direct marketplace support is a reimbursement for a specific, incremental and identifiable program, the funding is recorded as an adjustment to net revenues. Prior to 2003, all direct marketplace support was recorded as an adjustment to net revenues.
- Capital equipment funding is designed to help offset the costs of purchasing and installing marketing equipment, such as vending machines and glass door coolers at customer locations and is recorded as a reduction of cost of sales. Prior to 2003, capital equipment funding was recorded as a reduction to selling, delivery and administrative expenses.
- Advertising support represents agreed-upon funding to assist us for the cost of media time and promotional

materials and is generally recorded as an adjustment to cost of sales. Advertising support that represents reimbursement for a specific, incremental and identifiable media cost, is recorded as a reduction to advertising and marketing expenses within selling, delivery and administrative expenses. Prior to 2003, all funding for media costs was recorded as an adjustment to selling, delivery and administrative expenses.

Total bottler incentives recognized as adjustments to net revenues, cost of sales and selling, delivery and administrative expenses in our Consolidated Statements of Operations were as follows:

	52 Weeks Ended		
	2004	2003	2002
Net revenues	\$ 22	\$ 21	\$293
Cost of sales	559	561	–
Selling, delivery and administrative expenses	84	108	311
Total bottler incentives	\$665	\$690	\$604

See “New Accounting Standards” for the pro forma disclosure to our reported results for the fifty-two weeks ended December 28, 2002, assuming that EITF Issue No. 02-16 had been in place for all periods presented.

Shipping and Handling Costs – Our shipping and handling costs are recorded primarily within selling, delivery and administrative expenses. Such costs recorded within selling, delivery and administrative expenses totaled \$1,564 million, \$1,438 million and \$1,213 million in 2004, 2003 and 2002, respectively.

Foreign Currency Gains and Losses – We translate the balance sheets of our foreign subsidiaries that do not operate in highly inflationary economies at the exchange rates in effect at the balance sheet date, while we translate the statements of operations at the average rates of exchange during the year. The resulting translation adjustments of our foreign subsidiaries are recorded directly to accumulated other comprehensive loss. Foreign currency gains and losses reflect both transaction gains and losses in our foreign operations, as well as translation gains and losses arising from the remeasurement into U.S. dollars of the net monetary assets of businesses in highly inflationary countries. Turkey and Russia were considered highly inflationary economies for accounting purposes in 2002.

Beginning in 2003, Russia was no longer considered highly inflationary, and as a result, changed its functional currency from the U.S. dollar to the Russian ruble. There was no material impact on our consolidated financial statements as a result of Russia’s change in functional currency. For 2004 and 2003, Turkey was still considered a highly inflationary economy for accounting purposes.

Pension and Postretirement Medical Benefit Plans – We sponsor pension and other postretirement medical benefit plans in various forms covering substantially all employees who meet eligibility requirements. We account for our defined benefit pension plans and our postretirement medical benefit plans using actuarial models required by Statement of Financial Accounting Standards (“SFAS”) No. 87, “Employers’ Accounting for Pensions,” and SFAS No. 106, “Employers’ Accounting for Postretirement Benefits Other Than Pensions.”

The assets, liabilities and assumptions used to measure pension and postretirement medical expense for any fiscal year are determined as of September 30 of the preceding year (“measurement date”). The discount rate assumption used in our pension and postretirement medical benefit plans’ accounting is based on current interest rates for high-quality, long-term corporate debt as determined on each measurement date. In evaluating our rate of return on assets for a given fiscal year, we consider the 10–15 year historical return of our pension investment portfolio, reflecting the weighted return of our pension plan asset allocation. Differences between actual and expected returns are generally recognized in the net periodic pension calculation over five years. To the extent the amount of all unrecognized gains and losses exceeds 10% of the larger of the pension benefit obligation or plan assets, such amount is amortized over the average remaining service life of active participants. We amortize prior service costs on a straight-line basis over the average remaining service period of employees expected to receive benefits.

Income Taxes – Our effective tax rate is based on pre-tax income, statutory tax rates, tax regulations and tax planning strategies available to us in the various jurisdictions in which we operate. The tax bases of our assets and liabilities reflect our best estimate of the tax benefit and costs we expect to realize. We establish valuation allowances to reduce our deferred tax assets to an amount that will more likely than not be realized.

Significant management judgment is required in determining our effective tax rate and in evaluating our tax position. We establish reserves when, despite our belief that our tax return positions are supportable, we believe these positions may be challenged. We adjust these reserves as warranted by changing facts and circumstances. A change in our tax reserves could have a significant impact on our results of operations.

Earnings Per Share – We compute basic earnings per share by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock that would then participate in net income.

Cash Equivalents – Cash equivalents represent funds we have temporarily invested with original maturities not exceeding three months.

Allowance for Doubtful Accounts – A portion of our accounts receivable will not be collected due to customer disputes, bankruptcies and sales returns. We provide reserves for these situations based on the evaluation of the aging of our trade receivable portfolio and an in-depth analysis of our high-risk customers. Our reserves contemplate our historical loss rate on receivables, specific customer situations and the economic environments in which we operate.

Inventories – We value our inventories at the lower of cost or net realizable value. The cost of our inventory is generally computed on the first-in, first-out method.

Property, Plant and Equipment – We state property, plant and equipment (“PP&E”) at cost, except for PP&E that has been impaired, for which we write down the carrying amount to estimated fair market value, which then becomes the new cost basis.

Goodwill and Other Intangible Assets, net – Goodwill and intangible assets with indefinite useful lives are not amortized, but instead tested annually for impairment.

We evaluate our identified intangible assets with indefinite useful lives for impairment annually (unless it is required

Notes to Consolidated Financial Statements

more frequently because of a triggering event) on an individual basis or by asset groups on a country-by-country basis, depending on the nature of the intangible asset. We measure impairment as the amount by which the carrying value exceeds its estimated fair value. Based upon our annual impairment analysis performed in the fourth quarter of 2004, the estimated fair values of our identified intangible assets with indefinite lives exceeded their carrying amounts. However, we recorded a \$9 million non-cash impairment charge in the fourth quarter due to our re-evaluation of the fair value of our franchise licensing agreement for **SQUIRT** resulting from our negotiations with Cadbury in December 2004. See Note 6 – Other Intangible Assets, Net and Goodwill for additional information.

We evaluate goodwill on a country-by-country basis (“reporting unit”) for impairment. We evaluate each reporting unit for impairment based upon a two-step approach. First, we compare the fair value of our reporting unit with its carrying value. Second, if the carrying value of our reporting unit exceeds its fair value, we compare the implied fair value of the reporting unit’s goodwill to its carrying amount to measure the amount of impairment loss. In measuring the implied fair value of goodwill, we would allocate the fair value of the reporting unit to each of its assets and liabilities (including any unrecognized intangible assets). Any excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. Based upon our annual impairment analysis in the fourth quarter of 2004, the estimated fair value of our reporting units exceeded their carrying value, and as a result, we did not need to proceed to the second step of the impairment test.

Other identified intangible assets that are subject to amortization are amortized on a straight-line basis over the period in which we expect to receive economic benefit and are reviewed for impairment when facts and circumstances indicate that the carrying value of the asset may not be recoverable. The determination of the expected life will be dependent upon the use and underlying characteristics of the intangible asset. In our evaluation of the intangible assets, we consider the nature and terms of the underlying agreements, the customer’s attrition rate, competitive environment and brand history, as applicable. If the carrying value is not recoverable, impairment is measured as the amount by which

the carrying value exceeds its estimated fair value. Fair value is generally estimated based on either appraised value or other valuation techniques.

Casualty Insurance Costs – In the United States, we are self-insured for workers’ compensation and automobile risks for occurrences up to \$10 million, and product and general liability risks for occurrences up to \$5 million. For losses exceeding these self-insurance thresholds, we purchase casualty insurance from a third-party provider. Our liability for casualty costs was \$169 million as of December 25, 2004 of which \$55 million was reported in accounts payable and other current liabilities and \$114 million was recorded in other liabilities in our Consolidated Balance Sheets. Our liability for casualty costs is estimated using individual case-based valuations and statistical analyses and is based upon historical experience, actuarial assumptions and professional judgment. We do not discount our loss expense reserves.

Minority Interest – PBG and PepsiCo contributed bottling businesses and assets used in the bottling businesses to Bottling Group, LLC, our principal operating subsidiary, in connection with the formation of Bottling Group, LLC in February 1999. At December 25, 2004, PBG owns 93.2% of Bottling Group, LLC and PepsiCo owns the remaining 6.8%. Accordingly, the Consolidated Financial Statements reflect PepsiCo’s share of the consolidated net income of Bottling Group, LLC as minority interest in our Consolidated Statements of Operations, and PepsiCo’s share of consolidated net assets of Bottling Group, LLC as minority interest in our Consolidated Balance Sheets.

Treasury Stock – We record the repurchase of shares of our common stock at cost and classify these shares as treasury stock within shareholders’ equity. Repurchased shares are included in our authorized and issued shares but not included in our shares outstanding. We record shares reissued using an average cost. Since the inception of our share repurchase program in October 1999, we have repurchased approximately 84 million shares and have reissued approximately 23 million for stock option exercises.

Financial Instruments and Risk Management – We use derivative instruments to hedge against the risk of adverse movements associated with commodity prices, interest rates and foreign currency. Our corporate policy prohibits the use of derivative

instruments for trading or speculative purposes, and we have procedures in place to monitor and control their use.

All derivative instruments are recorded at fair value as either assets or liabilities in our Consolidated Balance Sheets. Derivative instruments are generally designated and accounted for as either a hedge of a recognized asset or liability (“fair value hedge”) or a hedge of a forecasted transaction (“cash flow hedge”). The derivative’s gain or loss recognized in earnings is recorded consistent with the expense classification of the underlying hedged item.

If a fair value or cash flow hedge were to cease to qualify for hedge accounting or were terminated, it would continue to be carried on the balance sheet at fair value until settled, but hedge accounting would be discontinued prospectively. If a forecasted transaction was no longer probable of occurring, amounts previously deferred in accumulated other comprehensive loss would be recognized immediately in earnings.

On occasion, we enter into derivative instruments that do not qualify for hedge accounting. These instruments are reflected in the Consolidated Balance Sheets at fair value with changes in fair value recognized in earnings.

We also may enter into a derivative instrument for which hedge accounting is not required because it is entered into to offset changes in the fair value of an underlying transaction recognized in earnings (“natural hedge”). These instruments are reflected in the Consolidated Balance Sheets at fair value with changes in fair value recognized in earnings.

Stock-Based Employee Compensation – We measure stock-based compensation expense using the intrinsic value method in accordance with Accounting Principles Board (“APB”) Opinion 25, “Accounting for Stock Issued to Employees,” and its related interpretations. Accordingly, compensation expense for stock option and restricted stock grants to our employees is measured as the excess of the quoted market price of common stock at the grant date over the amount the employee must pay for the stock. Our policy is to grant stock options based upon the fair value of the PBG stock on the date of grant. As allowed by SFAS No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure, an Amendment of FASB Statement No. 123,” we have elected to continue to

apply the intrinsic value-based method of accounting described above, and have adopted the disclosure requirements of SFAS No. 123 “Accounting for Stock-Based Compensation.” If we had measured compensation cost for the stock-based awards granted to our employees under the fair value-based method prescribed by SFAS No. 123, net income would have been changed to the pro forma amounts set forth below:

	52 Weeks Ended		
	2004	2003	2002
Net income:			
As reported	\$ 457	\$ 416	\$ 428
Add: Total stock-based employee compensation expense included in reported net income, net of taxes and minority interest	–	2	–
Less: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of taxes and minority interest	(37)	(42)	(40)
Pro forma	\$ 420	\$ 376	\$ 388
Earnings per share:			
Basic – as reported	\$1.79	\$1.54	\$1.52
Basic – pro forma	\$1.64	\$1.39	\$1.38
Diluted – as reported	\$1.73	\$1.50	\$1.46
Diluted – pro forma	\$1.59	\$1.35	\$1.32

Pro forma compensation cost measured for equity awards granted to employees is amortized using a straight-line basis over the vesting period, which is typically three years.

The fair value of PBG stock options used to compute pro forma net income disclosures was estimated on the date of grant using the Black-Scholes-Merton option-pricing model based on the following weighted-average assumptions:

	2004	2003	2002
Risk-free interest rate	3.2%	2.9%	4.5%
Expected life	6 years	6 years	6 years
Expected volatility	35%	37%	37%
Expected dividend yield	0.68%	0.17%	0.16%

Commitments and Contingencies – We are subject to various claims and contingencies related to lawsuits, taxes, environmental and other matters arising out of the normal course of business.

Notes to Consolidated Financial Statements

Liabilities related to commitments and contingencies are recognized when a loss is probable and reasonably estimable.

New Accounting Standards

EITF Issue No. 02-16 – As discussed above in Note 2, the EITF reached a consensus on Issue No. 02-16 in 2003, addressing the recognition and income statement classification of various cash consideration given by a vendor to a customer. In accordance with EITF Issue No. 02-16, we have classified certain bottler incentives as a reduction of cost of sales beginning in 2003. During 2003, we recorded a transition adjustment of \$6 million, net of taxes and minority interest of \$1 million, for the cumulative effect on prior years. This adjustment reflects the amount of bottler incentives that can be attributed to our 2003 beginning inventory balances. Assuming that EITF Issue No. 02-16 had been in place for all periods presented, the following pro forma adjustments would have been made to our reported results for the fifty-two weeks ended December 28, 2002:

52 Weeks Ended December 28, 2002			
	As Reported	EITF 02-16 Adjustment	Pro Forma Results
Net revenues	\$9,216	\$(290)	\$8,926
Cost of sales	5,001	(491)	4,510
Selling, delivery and administrative expenses	3,317	201	3,518
Operating income	\$ 898	\$ —	\$ 898

Assuming EITF Issue No. 02-16 had been adopted for all periods presented, pro forma net income and earnings per share for the fifty-two weeks ended December 25, 2004, December 27, 2003, and December 28, 2002, would have been as follows:

52 Weeks Ended			
	December 25, 2004	December 27, 2003	December 28, 2002
Net income:			
As reported	\$ 457	\$ 416	\$ 428
Pro forma	\$ 457	\$ 422	\$ 428
Earnings per share:			
Basic – as reported	\$1.79	\$1.54	\$1.52
Basic – pro forma	\$1.79	\$1.56	\$1.52
Diluted – as reported	\$1.73	\$1.50	\$1.46
Diluted – pro forma	\$1.73	\$1.52	\$1.46

FASB Staff Position FAS 106-2 – During the second quarter of 2004, the Financial Accounting Standards Board (“FASB”) issued FASB Staff Position FAS 106-2, “Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003.” See Note 11 – Pension and Postretirement Medical Benefit Plans for further details regarding the impact of FASB Staff Position FAS 106-2.

Share-Based Payments – During the fourth quarter of 2004, the FASB issued SFAS No. 123R, “Share-Based Payments: an amendment of FASB Statements 123 and 95,” which requires companies to expense the fair value of share-based payments provided to employees. The grant-date fair value of the employee share options and similar instruments will be estimated using option-pricing models. SFAS No. 123R becomes effective for interim periods beginning after June 15, 2005. We are currently evaluating the impact of this proposed standard on our financial statements.

NOTE 3 INVENTORIES

	2004	2003
Raw materials and supplies	\$159	\$140
Finished goods	268	234
	\$427	\$374

NOTE 4 PREPAID EXPENSES AND OTHER CURRENT ASSETS

	2004	2003
Prepaid expenses	\$198	\$223
Other assets	55	45
	\$253	\$268

NOTE 5 PROPERTY, PLANT AND EQUIPMENT, NET

	2004	2003
Land	\$ 257	\$ 241
Buildings and improvements	1,263	1,185
Manufacturing and distribution equipment	3,289	3,028
Marketing equipment	2,237	2,131
Other	177	176
	7,223	6,761
Accumulated depreciation	(3,642)	(3,338)
	\$ 3,581	\$ 3,423

We calculate depreciation on a straight-line basis over the estimated lives of the assets as follows:

Buildings and improvements	20–33 years
Manufacturing and distribution equipment	2–15 years
Marketing equipment	3–7 years

NOTE 6 OTHER INTANGIBLE ASSETS, NET AND GOODWILL

	2004	2003
Intangibles subject to amortization:		
Gross carrying amount:		
Customer relationships and lists	\$ 46	\$ 42
Franchise/distribution rights	44	23
Other identified intangibles	30	27
	120	92
Accumulated amortization:		
Customer relationships and lists	(6)	(3)
Franchise/distribution rights	(15)	(10)
Other identified intangibles	(16)	(12)
	(37)	(25)
Intangibles subject to amortization, net	83	67
Intangibles not subject to amortization:		
Carrying amount:		
Franchise rights	2,958	2,908
Distribution rights	288	286
Trademarks	208	207
Other identified intangibles	102	94
Intangibles not subject to amortization	3,556	3,495
Total other intangible assets, net	\$3,639	\$3,562
Goodwill	\$1,416	\$1,386

In 2004, total other intangible assets, net and goodwill increased by approximately \$107 million due to the following:

	Goodwill	Other Intangible Assets, net	Total
Balance at December 27, 2003	\$1,386	\$3,562	\$4,948
Purchase price allocations relating to recent acquisitions	9	65	74
Impact of foreign currency translation	21	31	52
Intangible asset impairment charge	–	(9)	(9)
Increase in pension asset	–	3	3
Amortization of intangible assets	–	(13)	(13)
Balance at December 25, 2004	\$1,416	\$3,639	\$5,055

During the fourth quarter we recorded a \$9 million non-cash impairment charge (\$6 million net of tax and minority interest) in selling, delivery and administrative expenses relating to our re-evaluation of the fair value of our franchise licensing agreement for the SQUIRT trademark in Mexico, as a result of a change in its estimated accounting life. The franchise licensing agreements for the SQUIRT trademark were considered to have an indefinite life and granted The Pepsi Bottling Group Mexico S.R.L. (“PBG Mexico”) the exclusive right to produce, sell, and distribute beverages under the SQUIRT trademark in certain territories of Mexico. In December 2004, Cadbury Bebidas, S.A. de C.V. (“Cadbury Mexico”), the owner of the SQUIRT trademark, sent PBG Mexico notices that purportedly terminated the SQUIRT licenses for these territories effective January 15, 2005. PBG Mexico believes that these licenses continue to be in effect and that Cadbury Mexico has no legally supportable basis to terminate the licenses. However, as a result of these recent unanticipated actions, PBG Mexico is no longer certain that it will have the right to distribute SQUIRT in Mexico after certain of its contractual rights expire in 2015. Accordingly, we have concluded that the franchise rights relating to the SQUIRT trademark should no longer be considered to have an indefinite life, but should be treated as having a 10-year life for accounting purposes. Due to the reduction in the useful life of these franchise rights, we wrote the carrying value of the SQUIRT franchise rights down to its current estimated fair value. The remaining carrying value will be amortized over the estimated useful life of 10 years, resulting in approximately \$2 million of expense each year, starting in 2005.

We measured the fair value of SQUIRT’s franchise rights using a multi-period excess earnings method, which was based upon estimated discounted future cash flows for 10 years. We deducted a contributory charge from our net after-tax cash flows for the economic return attributable to the working capital and property, plant and equipment, for SQUIRT’s franchise rights. The net discounted cash flows in excess of the fair returns on these assets represent the fair value of the SQUIRT franchise rights.

Notes to Consolidated Financial Statements

In 2003, total other intangible assets, net and goodwill increased by approximately \$261 million due to the following:

	Goodwill	Other Intangible Assets, net	Total
Balance at December 28, 2002	\$1,192	\$3,495	\$4,687
Purchase price allocations relating to recent acquisitions	163	66	229
Impact of foreign currency translation	31	8	39
Increase in pension asset	—	5	5
Amortization of intangible assets	—	(12)	(12)
Balance at December 27, 2003	\$1,386	\$3,562	\$4,948

For intangible assets subject to amortization, we calculate amortization expense over the period we expect to receive economic benefit. Total amortization expense was \$13 million, \$12 million and \$8 million in 2004, 2003 and 2002, respectively. The weighted-average amortization period for each category of intangible assets and its estimated aggregate amortization expense expected to be recognized over the next five years are as follows:

	Weighted-Average Amortization Period	Estimated Aggregate Amortization Expense to be Incurred				
		Fiscal Year Ending				
		2005	2006	2007	2008	2009
Customer relationships and lists	17 years	\$3	\$3	\$3	\$3	\$3
Franchise/distribution rights	7 years	\$6	\$4	\$3	\$2	\$2
Other identified intangibles	7 years	\$5	\$4	\$3	\$2	\$1

NOTE 7 ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES

	2004	2003
Accounts payable	\$ 493	\$ 392
Trade incentives	201	220
Accrued compensation and benefits	222	162
Other accrued taxes	117	114
Accrued interest	60	86
Other current liabilities	280	257
	\$1,373	\$1,231

NOTE 8 SHORT-TERM BORROWINGS AND LONG-TERM DEBT

	2004	2003
Short-term borrowings		
Current maturities of long-term debt	\$ 53	\$1,180
Other short-term borrowings	155	67
	\$ 208	\$1,247
Long-term debt		
5.63% (4.85% effective rate) ⁽¹⁾ senior notes due 2009	\$1,300	\$1,300
5.38% (3.53% effective rate) ⁽¹⁾ senior notes due 2004	—	1,000
7.00% (7.10% effective rate) senior notes due 2029	1,000	1,000
4.63% (4.57% effective rate) senior notes due 2012	1,000	1,000
2.45% (2.26% effective rate) ⁽¹⁾ senior notes due 2006	500	500
5.00% (5.12% effective rate) senior notes due 2013	400	400
4.13% (4.35% effective rate) senior notes due 2015	250	250
9.75% (3.70% effective rate) ⁽²⁾ senior notes due 2004	—	160
Other (average rate 3.34%)	109	71
	4,559	5,681
Add: SFAS No. 133 adjustment ⁽³⁾	(4)	3
Fair value adjustment relating to purchase accounting	—	3
Less: Unamortized discount, net	13	14
Current maturities of long-term debt	53	1,180
	\$4,489	\$4,493

- (1) Effective interest rates include the impact of the gain/loss realized on swap instruments and represent the rates that were achieved in 2004.
- (2) Effective interest rate includes the impact resulting from the fair value adjustment relating to our acquisition of Gemex.
- (3) In accordance with the requirements of SFAS No. 133, the portion of our fixed-rate debt obligations that is hedged is reflected in our Consolidated Balance Sheets as an amount equal to the sum of the debt's carrying value plus a SFAS No. 133 fair value adjustment representing changes recorded in the fair value of the hedged debt obligations attributable to movements in market interest rates.

Maturities of long-term debt as of December 25, 2004, are 2005: \$53 million, 2006: \$510 million, 2007: \$38 million, 2008: \$4 million, 2009: \$1,300 million and thereafter, \$2,654 million. The maturities of long-term debt do not include the non-cash impact of the SFAS No. 133 adjustment and the interest effect of the unamortized discount.

Our \$1.3 billion of 5.63% senior notes due in 2009 and our \$1.0 billion of 4.63% senior notes due in 2012 are guaranteed by PepsiCo.

During the first quarter, we repaid our \$1 billion 5.38% senior notes with the proceeds we received from debt issued in the prior year.

In 2002, we purchased \$181 million in U.S. government securities and placed those securities into an irrevocable trust, for the sole purpose of funding payments of principal and interest on the \$160 million of 9.75% senior notes maturing in March 2004, in order to defease their respective covenants. In March 2004, we repaid our \$160 million of 9.75% senior notes by liquidating our investments in our debt defeasance trust.

We have a \$500 million commercial paper program in the U.S. that is supported by a credit facility, which is guaranteed by Bottling Group, LLC and expires in April 2009. At December 25, 2004, we had \$78 million in outstanding commercial paper with a weighted-average interest rate of 2.32%. At December 27, 2003, we had no outstanding commercial paper.

We had available short-term bank credit lines of approximately \$381 million and \$302 million at December 25, 2004 and December 27, 2003, respectively. These lines were used to support the general operating needs of our businesses outside the United States. As of year end 2004, we had \$77 million outstanding under these lines of credit at a weighted-average interest rate of 3.72%. As of year end 2003, we had \$67 million outstanding under these lines of credit at a weighted-average interest rate of 4.17%.

Certain of our senior notes have redemption features and non-financial covenants and will, among other things, limit our ability to create or assume liens, enter into sale and lease-back transactions, engage in mergers or consolidations and transfer or lease all or substantially all of our assets.

Additionally, certain of our credit facilities and senior notes have financial covenants consisting of the following:

- Our debt to capitalization ratio should not be greater than .75 on the last day of a fiscal quarter when PepsiCo Inc.'s ratings are A- by S&P and A3 by Moody's or higher. Debt is defined as total long-term and short-term debt plus accrued interest plus total standby letters of credit and other guarantees less cash and cash equivalents not in excess of \$500 million. Capitalization is defined as debt plus shareholders equity plus minority interest excluding the impact of the cumulative translation adjustment.
- Our debt to EBITDA ratio should not be greater than five on the last day of a fiscal quarter when PepsiCo Inc.'s ratings are less than A- by S&P or A3 by Moody's. EBITDA is defined as the last four quarters of earnings before depreciation, amortization, net interest expense, income taxes, minority interest, net other non-operating expenses and extraordinary items.
- New secured debt should not be greater than 10% of Bottling Group, LLC's net tangible assets. Net tangible assets are defined as total assets less current liabilities and net intangible assets.

We are in compliance with all debt covenants.

Amounts paid to third parties for interest, net of cash received from our interest rate swaps, was \$232 million, \$243 million and \$198 million in 2004, 2003 and 2002, respectively. Total interest expense incurred during 2004, 2003 and 2002 was \$236 million, \$247 million and, \$200 million, respectively.

At December 25, 2004, we have outstanding letters of credit, bank guarantees and surety bonds valued at \$217 million from financial institutions primarily to provide collateral for estimated self-insurance claims and other insurance requirements.

NOTE 9 LEASES

We have noncancellable commitments under both capital and long-term operating leases, which consist principally of buildings, office equipment and machinery. Capital and operating lease commitments expire at various dates through 2072. Most leases require payment of related executory costs, which include property taxes, maintenance and insurance.

Our future minimum commitments under noncancellable leases are set forth below:

	Leases	
	Capital	Operating
2005	\$2	\$ 45
2006	1	37
2007	—	31
2008	—	23
2009	1	20
Later years	2	66
	\$6	\$222

At December 25, 2004, the present value of minimum payments under capital leases was \$4 million, after deducting \$2 million for imputed interest. Our rental expense was \$75 million, \$69 million and \$62 million for 2004, 2003 and 2002, respectively. We plan to receive \$6 million of sublease income for the periods 2005 through 2013.

NOTE 10 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Cash Flow Hedges – We are subject to market risk with respect to the cost of commodities because our ability to recover increased costs through higher pricing may be limited by the competitive environment in which we operate. We use future and option contracts to hedge the risk of adverse movements in commodity prices related primarily to anticipated purchases of aluminum and fuel used in our operations. These contracts generally range from one to 12 months in duration and qualify for cash flow hedge accounting treatment.

We are subject to foreign currency transactional risks in certain of our international territories for transactions that are denominated in currencies that are different from their functional currency. Beginning in 2004, we have entered into forward exchange contracts to hedge portions of our forecasted U.S. dollar purchases in our Canadian business. These contracts generally range from one to 12 months in duration and qualify for cash flow hedge accounting treatment.

We have also entered into treasury rate future contracts to hedge against adverse interest rate changes on debt issued in 2003 and 2002.

For a cash flow hedge, the effective portion of the change in the fair value of a derivative instrument, which is highly

effective, is deferred in accumulated other comprehensive loss until the underlying hedged item is recognized in earnings. The ineffective portion of a fair value change on a qualifying cash flow hedge is recognized in earnings immediately and is recorded consistent with the expense classification of the underlying hedged item.

The following summarizes activity in accumulated other comprehensive loss (AOCL) related to derivatives designated as cash flow hedges held by the Company during the applicable periods:

	Before Minority Interest and Taxes	Minority Interest	Taxes	Net of Minority Interest and Taxes
Year ended December 25, 2004				
Accumulated net gains as of December 27, 2003	\$ 22	\$ (1)	\$ (8)	\$ 13
Net changes in the fair value of cash flow hedges	29	(2)	(10)	17
Net gains reclassified from AOCL into earnings	(34)	2	12	(20)

Accumulated net gains as of December 25, 2004	\$ 17	\$ (1)	\$ (6)	\$ 10
--	--------------	---------------	---------------	--------------

	Before Minority Interest and Taxes	Minority Interest	Taxes	Net of Minority Interest and Taxes
Year ended December 27, 2003				
Accumulated net losses as of December 28, 2002	\$ (9)	\$ 1	\$ 3	\$ (5)
Net changes in the fair value of cash flow hedges	29	(2)	(10)	17
Net losses reclassified from AOCL into earnings	2	—	(1)	1

Accumulated net gains as of December 27, 2003	\$22	\$(1)	\$(8)	\$13
--	------	-------	-------	------

Assuming no change in the commodity prices and foreign currency rates as measured on December 25, 2004, \$14 million of the deferred gain will be recognized in earnings over the next 12 months. The ineffective portion of the change in fair value of these contracts was not material to our results of operations in 2004, 2003 or 2002.

Fair Value Hedges – We finance a portion of our operations through fixed-rate debt instruments. We effectively converted \$800 million of our senior notes to floating rate

debt through the use of interest rate swaps with the objective of reducing our overall borrowing costs. These interest rate swaps meet the criteria for fair value hedge accounting and are 100% effective in eliminating the market rate risk inherent in our long-term debt. Accordingly, any gain or loss associated with these swaps is fully offset by the opposite market impact on the related debt. The change in fair value of the interest rate swaps was a decrease of \$7 million and \$20 million in 2004 and 2003, respectively. In 2004, the fair value change of our swaps and debt have been recorded in other liabilities and long-term debt in our Consolidated Balance Sheets. In 2003, the fair value change of our swaps and debt have been recorded in other assets and long-term debt in our Consolidated Balance Sheets.

Unfunded Deferred Compensation Liability – Our unfunded deferred compensation liability is subject to changes in our stock price as well as price changes in other equity and fixed-income investments. Participating employees in our deferred compensation program can elect to defer all or a portion of their compensation to be paid out on a future date or dates. As part of the deferral process, employees select from phantom investment options that determine the earnings on the deferred compensation liability and the amount that they will ultimately receive. Employee investment elections include PBG stock and a variety of other equity and fixed-income investment options.

Since the plan is unfunded, employees’ deferred compensation amounts are not directly invested in these investment vehicles. Instead, we track the performance of each employee’s investment selections and adjust his or her deferred compensation account accordingly. The adjustments to the employees’ accounts increases or decreases the deferred compensation liability reflected on our Consolidated Balance Sheets with an offsetting increase or decrease to our selling, delivery and administrative expenses.

We use prepaid forward contracts to hedge the portion of our deferred compensation liability that is based on our stock price. At December 25, 2004, we had a prepaid forward contract for 638,000 shares at an exercise price of \$26.90, which was accounted for as a natural hedge. This contract requires cash settlement and has a fair value at December 25, 2004, of \$17 million recorded in prepaid expenses and other current assets in our Consolidated Balance Sheets. The fair value of this contract changes based on the change in our stock price compared with the contract exercise price.

We recognized \$2 million in income in 2004 and \$1 million in losses in 2003, resulting from the change in fair value of these prepaid forward contracts. The earnings impact from these instruments is classified as selling, delivery and administrative expenses.

Other Financial Assets and Liabilities – Financial assets with carrying values approximating fair value include cash and cash equivalents and accounts receivable. Financial liabilities with carrying values approximating fair value include accounts payable and other accrued liabilities and short-term debt. The carrying value of these financial assets and liabilities approximates fair value due to their short maturities and since interest rates approximate current market rates for short-term debt.

Long-term debt at December 25, 2004, had a carrying value and fair value of \$4.6 billion and \$4.8 billion, respectively, and at December 27, 2003, had a carrying value and fair value of \$5.7 billion and \$6.0 billion, respectively. The fair value is based on interest rates that are currently available to us for issuance of debt with similar terms and remaining maturities.

NOTE 11 PENSION AND POSTRETIREMENT MEDICAL BENEFIT PLANS

Pension Benefits

Our U.S. employees participate in noncontributory defined benefit pension plans, which cover substantially all full-time salaried employees, as well as most hourly employees. Benefits generally are based on years of service and compensation, or stated amounts for each year of service. All of our qualified plans are funded and contributions are made in amounts not less than minimum statutory funding requirements and not more than the maximum amount that can be deducted for U.S. income tax purposes. Our net pension expense for the defined benefit plans for our operations outside the U.S. was not significant and is not included in the tables presented below.

Nearly all of our U.S. employees are also eligible to participate in our 401(k) savings plans, which are voluntary defined contribution plans. We make matching contributions to the 401(k) savings plans on behalf of participants eligible to receive such contributions. If a participant has one or more but less than 10 years of eligible service, our match will equal \$0.50 for each dollar the participant elects to defer up to 4% of the participant’s pay. If the participant has 10 or more years of eligible service, our match will equal \$1.00 for each dollar the participant elects to defer up to 4% of the participant’s pay.

Notes to Consolidated Financial Statements

Components of U.S. pension expense:

	Pension		
	2004	2003	2002
Service cost	\$ 43	\$ 37	\$ 28
Interest cost	69	63	56
Expected return on plan assets	(83)	(67)	(66)
Amortization of prior service amendments	7	6	6
Amortization of net loss	25	13	—
Special termination benefits	—	—	1
Net pension expense for the defined benefit plans	\$ 61	\$ 52	\$ 25
Defined contribution plans expense	\$ 19	\$ 19	\$ 18
Total pension expense recognized in the Consolidated Statements of Operations	\$ 80	\$ 71	\$ 43

Postretirement Medical Benefits

Our postretirement medical plans provide medical and life insurance benefits principally to U.S. retirees and their dependents. Employees are eligible for benefits if they meet age and service requirements and qualify for retirement benefits. The plans are not funded and since 1993 have included retiree cost sharing.

Components of U.S. postretirement benefits expense:

	Postretirement		
	2004	2003	2002
Service cost	\$ 4	\$ 3	\$ 3
Interest cost	18	19	17
Amortization of net loss	6	5	2
Amortization of prior service amendments	(1)	(2)	(6)
Net postretirement benefits expense recognized in the Consolidated Statements of Operations	\$27	\$25	\$16

Changes in the projected benefit obligations:

	Pension		Postretirement	
	2004	2003	2004	2003
Obligation at beginning of year	\$1,129	\$ 953	\$312	\$286
Service cost	43	37	4	3
Interest cost	69	63	18	19
Plan amendments	11	11	—	—
Actuarial loss	48	112	19	22
Benefit payments	(46)	(47)	(22)	(18)
LTD medical merger ⁽¹⁾	—	—	62	—
Gain due to Medicare subsidy	—	—	(14)	—
Transfers	(2)	—	—	—
Obligation at end of year	\$1,252	\$1,129	\$379	\$312

(1) In 2004, we merged our long-term disability medical plan with our post-retirement medical plan. Our long-term disability medical plan has been amended to provide coverage for two years for participants becoming disabled after January 1, 2005. Participants currently receiving benefits will be grand-fathered under the existing benefits program. The liabilities and respective costs associated with these participants have been added to our postretirement medical plan. If we merged our long-term disability medical plan into our postretirement medical plan in 2003, our projected benefit obligation would have increased by \$53 million.

Changes in the fair value of assets:

	Pension		Postretirement	
	2004	2003	2004	2003
Fair value at beginning of year	\$ 809	\$538	\$ —	\$ —
Actual return on plan assets	101	121	—	—
Transfers	(2)	—	—	—
Employer contributions	163	197	22	18
Benefit payments	(46)	(47)	(22)	(18)
Fair value at end of year	\$1,025	\$809	\$ —	\$ —

Additional plan information:

	Pension		Postretirement	
	2004	2003	2004	2003
Projected benefit obligation	\$1,252	\$1,129	\$379	\$312
Accumulated benefit obligation	\$1,150	\$1,006	\$379	\$312
Fair value of plan assets ⁽¹⁾	\$1,033	\$ 899	\$ —	\$ —

(1) Includes fourth quarter employer contributions.

The accumulated and projected obligations for all plans exceed the fair value of assets.

Funded status recognized on the Consolidated Balance Sheets:

	Pension		Postretirement	
	2004	2003	2004	2003
Funded status at end of year	\$(227)	\$(320)	\$(379)	\$(312)
Unrecognized prior service cost	50	46	(6)	(7)
Unrecognized loss	458	453	145	127
Fourth quarter employer contribution	8	90	8	6
Net amounts recognized	\$ 289	\$ 269	\$(232)	\$(186)

Net amounts recognized in the Consolidated Balance Sheets:

	Pension		Postretirement	
	2004	2003	2004	2003
Other liabilities	\$(136)	\$(124)	\$(232)	\$(186)
Intangible assets	50	47	—	—
Accumulated other comprehensive loss	375	346	—	—
Net amounts recognized	\$ 289	\$ 269	\$(232)	\$(186)
Increase in minimum liability included in accumulated other comprehensive loss in Shareholders' Equity	\$ 29	\$ 34	\$ —	\$ —

At December 25, 2004, and December 27, 2003, the accumulated benefit obligation of PBG's U.S. pension plans exceeded the fair market value of the plan assets resulting in the recognition of the unfunded liability as a minimum balance sheet liability. As a result of this additional liability, our intangible asset increased by \$3 million to \$50 million in 2004, which equals the amount of unrecognized prior service cost in our plans. The remainder of the liability that exceeded the unrecognized prior service cost was recognized as an increase to accumulated other comprehensive loss of \$29 million and \$34 million in 2004 and 2003, respectively, before taxes and minority interest. The adjustments to accumulated other comprehensive loss are reflected after minority interest of \$2 million and \$2 million, and deferred income taxes of \$11 million and \$12 million in 2004 and 2003, respectively, in our Consolidated Statements of Changes in Shareholders' Equity.

Assumptions

The weighted-average assumptions used to measure net expense for years ended:

	Pension			Postretirement		
	2004	2003	2002	2004	2003	2002
Discount rate	6.25%	6.75%	7.50%	6.25%	6.75%	7.50%
Expected return on plan assets ⁽¹⁾	8.50%	8.50%	9.50%	N/A	N/A	N/A
Rate of compensation increase	4.20%	4.34%	4.33%	4.20%	4.34%	4.33%

(1) Expected return on plan assets is presented after administration expenses.

The weighted-average assumptions used to measure the benefit liability as of the end of the year were as follows:

	Pension		Postretirement	
	2004	2003	2004	2003
Discount rate	6.15%	6.25%	6.15%	6.25%
Rate of compensation increase	3.60%	4.20%	3.60%	4.20%

We have evaluated these assumptions with our actuarial advisors and we believe that they are appropriate, although an increase or decrease in the assumptions or economic events outside our control could have a material impact on reported net income.

Funding and Plan Assets

Asset Category	Allocation Percentage		
	Target 2005	Actual 2004	Actual 2003
Equity securities	70%–75%	75%	74%
Debt securities	25%–30%	25%	26%

The table above shows the target allocation and actual allocation. Our target allocations of our plan assets reflect the long-term nature of our pension liabilities. None of the assets are invested directly in equity or debt instruments issued by PBG, PepsiCo or any bottling affiliates of PepsiCo, although it is possible that insignificant indirect investments exist through our broad market indices. Our equity investments are diversified across all areas of the equity market (i.e., large, mid and small capitalization stocks as well as international

Notes to Consolidated Financial Statements

equities). Our fixed income investments are also diversified and consist of both corporate and U.S. government bonds. We currently do not invest directly into any derivative investments. PBG’s assets are held in a pension trust account at our trustee’s bank.

PBG’s pension investment policy and strategy are mandated by PBG’s Pension Investment Committee (PIC) and are overseen by the PBG Board of Directors’ Compensation and Management Development Committee. The plan assets are invested using a combination of enhanced and passive indexing strategies. The performance of the plan assets is benchmarked against market indices and reviewed by the PIC. Changes in investment strategies, asset allocations and specific investments are approved by the PIC prior to execution.

Health Care Cost Trend Rates

We have assumed an average increase of 10.0% in 2005 in the cost of postretirement medical benefits for employees who retired before cost sharing was introduced. This average increase is then projected to decline gradually to 5.0% in 2013 and thereafter.

Assumed health care cost trend rates have an impact on the amounts reported for postretirement medical plans. A one-percentage point change in assumed health care costs would have the following impact:

	1% Increase	1% Decrease
Effect on total fiscal year 2004 service and interest cost components	\$1	\$(-)
Effect on the fiscal year 2004 accumulated postretirement benefit obligation	\$8	\$(7)

On May 19, 2004, FASB Staff Position No. FAS 106-2 (“FSP”) was issued by FASB to provide guidance relating to the prescription drug subsidy provided by the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (“Act”). We currently provide postretirement medical benefits to a group of retirees (employees who retired prior to the beginning of 1989) with little or no cost sharing. Additionally, we provide postretirement medical benefits to another group of retirees (employees who retired between 1989 and 1992) that will have cost sharing once their annual costs are twice the 2004 costs. For these retiree groups, the

prescription drug benefit provided by us would be considered to be actuarially equivalent to the benefit provided under the Act. Therefore, we retroactively applied the FSP to the date of enactment. As a result:

- The obligation (accumulated projected benefit obligation) decreased by \$14.3 million, and
- The net periodic postretirement medical benefits cost decreased by \$1.1 million for the year ended December 25, 2004.

There were no changes in estimates of participation or per capita claims costs as a result of the Act.

The specific authoritative guidance on the accounting for the Act is pending and that guidance, when issued, could require us to change previously reported information.

We also provide postretirement medical benefits to another group of retirees (employees who retired after 1992) with cost sharing. At present, due to the lack of clarifying regulations related to the Act, we cannot determine if the benefit provided by us would be considered actuarially equivalent to the benefit provided under the Act and therefore, we cannot determine its impact on our financial statements.

Pension and Postretirement Cash Flow

Our contributions are made in accordance with applicable tax regulations that provide us with current tax deductions for our contributions and for taxation to the employee when the benefits are received. We do not fund our pension plan and postretirement medical plans when our contributions would not be tax deductible or when benefits would be taxable to the employee before receipt. Of the total pension liabilities at December 25, 2004, \$49 million relates to plans not funded due to these unfavorable tax consequences.

Employer Contributions to U.S. Plans	Pension	Postretirement
2003	\$162	\$18
2004	\$ 81	\$22
2005 (expected)	\$ 56	\$29

Our 2005 expected contributions are intended to meet or exceed the IRS minimum requirements and provide us with current tax deductions.

Expected Benefit Payments

The expected benefit payments made from our pension and postretirement medical plans (with and without the subsidy received from the Act) to our participants over the next ten years are as follows:

	Postretirement		
		Including Medicare Subsidy	Excluding Medicare Subsidy
Expected Benefit Payments	Pension		
2005	\$ 48	\$ 29	\$ 29
2006	\$ 51	\$ 27	\$ 29
2007	\$ 55	\$ 28	\$ 29
2008	\$ 59	\$ 28	\$ 29
2009	\$ 63	\$ 28	\$ 30
2010 to 2014	\$400	\$143	\$150

NOTE 12 EMPLOYEE STOCK OPTION PLANS

Under our long-term incentive plan, stock options are issued to middle and senior management employees and vary according to salary and level within PBG. Except as noted below, options granted in 2004, 2003 and 2002 had exercise prices ranging from \$24.25 per share to \$30.25 per share, \$18.25 per share to \$25.50 per share and \$23.25 per share to \$29.25 per share, respectively, expire in 10 years and generally become exercisable 25% after one year, an additional 25% after two years, and the remainder after three years. We measure the fair value of our options on the date of grant using the Black-Scholes-Merton option-pricing model.

The following table summarizes option activity during 2004:

options in millions	Options	Weighted-Average	
		Exercise Price	
Outstanding at beginning of year	41.3	\$17.19	
Granted	7.1	\$29.54	
Exercised	(9.3)	\$12.86	
Forfeited	(0.7)	\$25.38	
Outstanding at end of year	38.4	\$20.35	
Exercisable at end of year	23.4	\$16.43	
Weighted-average fair value of options granted during the year		\$10.81	

The following table summarizes option activity during 2003:

options in millions	Options	Weighted-Average	
		Exercise Price	
Outstanding at beginning of year	37.4	\$15.53	
Granted	8.1	\$23.27	
Exercised	(3.1)	\$11.27	
Forfeited	(1.1)	\$22.44	
Outstanding at end of year	41.3	\$17.19	
Exercisable at end of year	26.9	\$13.93	
Weighted-average fair value of options granted during the year		\$ 9.29	

The following table summarizes option activity during 2002:

options in millions	Options	Weighted-Average	
		Exercise Price	
Outstanding at beginning of year	39.7	\$13.20	
Granted	6.4	\$25.32	
Exercised	(8.1)	\$11.63	
Forfeited	(0.6)	\$16.89	
Outstanding at end of year	37.4	\$15.53	
Exercisable at end of year	19.9	\$12.59	
Weighted-average fair value of options granted during the year		\$10.89	

Stock options outstanding and exercisable at December 25, 2004:

options in millions	Options Outstanding			Options Exercisable		
		Weighted-Average Remaining Contractual Life in Years	Weighted-Average Exercise Price		Weighted-Average Exercise Price	
Range of Exercise Price	Options			Options		
\$ 9.38–\$11.49	4.7	5.25	\$ 9.40	4.7		\$ 9.40
\$11.50–\$15.88	6.9	4.34	\$11.69	6.9		\$11.69
\$15.89–\$22.50	7.9	6.38	\$20.47	7.5		\$20.52
\$22.51–\$30.25	18.9	8.33	\$26.21	4.3		\$24.65
	38.4	6.83	\$20.35	23.4		\$16.43

Restricted Stock

For the years ended 2004, 2003, and 2002, we had 403,000, 359,000 and 8,000 shares, respectively, of restricted stock outstanding. During 2004, we granted 45,000 restricted shares with a weighted-average share price of \$24.25. During 2003, we granted 351,000 restricted shares with

Notes to Consolidated Financial Statements

a weighted-average share price of \$23.46. During 2002, we granted 2,000 restricted shares with a weighted-average share price of \$28.67.

NOTE 13 INCOME TAXES

The details of our income tax provision are set forth below:

	2004	2003	2002
Current:			
Federal	\$135	\$ 93	\$ 61
Foreign	35	12	12
State	17	8	17
	187	113	90
Deferred:			
Federal	54	74	115
Foreign	(22)	26	2
State	9	14	14
	41	114	131
	228	227	221
International tax structure change	30	–	–
Rate change (benefit)/expense	(26)	11	–
	232	238	221
Cumulative effect of change in accounting principle	–	(1)	–
	\$232	\$237	\$221

In 2004, we had the following significant tax items, which decreased our tax expense by approximately \$4 million:

- International tax structure change – In December 2004, we initiated a reorganization of our international tax structure to allow for more efficient cash mobilization and to reduce future tax costs. This reorganization triggered a \$30 million tax charge in the fourth quarter, of which \$14 million was recorded as part of our current provision and \$16 million was recorded in our deferred tax provision.
- Mexico tax rate change – In December 2004, legislation was enacted changing the Mexican statutory income tax rate. This rate change decreased our net deferred tax liabilities and resulted in a \$26 million tax benefit in the fourth quarter.
- Tax reserves – During 2004, we adjusted previously established liabilities for tax exposures due largely to the settlement of certain international tax audits. The adjustment of these liabilities resulted in an \$8 million tax benefit for the year.

Our 2003 income tax provision includes an increase in income tax expense of \$11 million due to enacted tax rate changes in Canada during the 2003 tax year.

Our U.S. and foreign income before income taxes is set forth below:

	2004	2003	2002
U.S.	\$550	\$533	\$573
Foreign	139	127	76
Income before income taxes and cumulative effect of change in accounting principle	\$689	\$660	\$649
Cumulative effect of change in accounting principle	–	(7)	–
	\$689	\$653	\$649

Our reconciliation of income taxes calculated at the U.S. federal statutory rate to our provision for income taxes is set forth below:

	2004	2003	2002
Income taxes computed at the U.S. federal statutory rate	35.0%	35.0%	35.0%
State income tax, net of federal tax benefit	2.2	1.9	2.8
Impact of foreign results ⁽¹⁾	(10.4)	(11.4)	(7.8)
Change in valuation allowances ⁽¹⁾	3.4	5.6	1.7
Nondeductible expenses	2.1	1.9	1.0
Net international tax audit settlements	(1.2)	–	–
Other, net	2.0	1.4	1.3
	33.1	34.4	34.0
Legal entity restructuring	4.3	–	–
Rate change (benefit)/expense	(3.7)	1.7	–
Total effective income tax rate before cumulative effect of change in accounting principle	33.7%	36.1%	34.0%
Cumulative effect of change in accounting principle	–	0.2	–
Total effective income tax rate	33.7%	36.3%	34.0%

(1) In 2004, we have reclassified certain Mexican net operating losses and their respective valuation allowances, which were recorded in 2003, to equity. We have determined that certain net operating losses resulting from the impact of a tax structure's foreign currency translational costs, correctly belong in equity. This reclassification had no impact on our Consolidated Financial Statements.

The details of our 2004 and 2003 deferred tax liabilities (assets) are set forth below:

	2004	2003
Intangible assets and property, plant and equipment	\$1,575	\$1,596
Other	112	52
Gross deferred tax liabilities	1,687	1,648
Net operating loss carryforwards	(356)	(255)
Employee benefit obligations	(179)	(181)
Bad debts	(17)	(21)
Various liabilities and other	(91)	(112)
Gross deferred tax assets	(643)	(569)
Deferred tax asset valuation allowance	320	271
Net deferred tax assets	(323)	(298)
Net deferred tax liability	\$1,364	\$1,350

Consolidated Balance Sheets Classification

Prepaid expenses and other current assets	\$ (51)	\$ (71)
Deferred income taxes	1,415	1,421
	\$1,364	\$1,350

We have net operating loss carryforwards totaling \$1,362 million at December 25, 2004, which are available to reduce future taxes in the U.S., Spain, Greece, Russia, Turkey and Mexico. Of these carryforwards, \$10 million expire in 2005 and \$1,352 million expire at various times between 2006 and 2024. At December 25, 2004, we have tax credit carryforwards in the U.S. of \$4 million with an indefinite carryforward period and in Mexico of \$15 million, which expire at various times between 2008 and 2014.

We establish valuation allowances for our deferred tax assets when the amount of expected future taxable income is not likely to support the use of the deduction or credit. Our valuation allowances, which reduce deferred tax assets to an amount that will more likely than not be realized, have increased by \$49 million in 2004 and increased by \$124 million in 2003.

Approximately \$17 million of our valuation allowance relating to our deferred tax assets at December 25, 2004 would be applied to reduce goodwill if reversed in future periods.

Deferred taxes are not recognized for temporary differences related to investments in foreign subsidiaries that are essentially permanent in duration. Determination of the amount of unrecognized deferred taxes related to these investments is not practicable. These undistributed earnings are approximately \$546 million at December 25, 2004. The American Jobs Creation Act of 2004 was enacted allowing for special tax breaks for the repatriation of earnings from foreign subsidiaries. We are evaluating whether to repatriate our undistributed foreign earnings in 2005.

Income taxes receivable from taxing authorities were \$50 million and \$68 million at December 25, 2004, and December 27, 2003, respectively. Such amounts are recorded within prepaid expenses and other current assets and other long-term assets in our Consolidated Balance Sheets. Income taxes payable to taxing authorities were \$17 million and \$24 million at December 25, 2004, and December 27, 2003, respectively. Such amounts are recorded within accounts payable and other current liabilities in our Consolidated Balance Sheets.

Income taxes receivable from related parties were \$5 million and \$6 million at December 25, 2004, and December 27, 2003, respectively. Such amounts are recorded within prepaids and other current assets in our Consolidated Balance Sheets. Amounts paid to taxing authorities and related parties for income taxes were \$172 million, \$115 million and \$49 million in 2004, 2003 and 2002, respectively.

Under our tax separation agreement with PepsiCo, PepsiCo maintains full control and absolute discretion for any combined or consolidated tax filings for tax periods ended on or before our initial public offering that occurred in March 1999. PepsiCo has contractually agreed to act in good faith with respect to all tax audit matters affecting us. In accordance with the tax separation agreement, we will share on a pro-rata basis any risk or upside resulting from the settlement of tax matters affecting us for these periods.

NOTE 14 GEOGRAPHIC DATA

We operate in one industry, carbonated soft drinks and other ready-to-drink beverages. We conduct business in the U.S., Mexico, Canada, Spain, Russia, Greece and Turkey.

Net Revenues			
	2004	2003	2002
U.S.	\$ 7,818	\$ 7,406	\$7,572
Mexico	1,071	1,105	164
Other countries	2,017	1,754	1,480
	\$10,906	\$10,265	\$9,216

Long-Lived Assets		
	2004	2003
U.S.	\$5,875	\$5,723
Mexico	1,435	1,432
Other countries	1,444	1,350
	\$8,754	\$8,505

NOTE 15 RELATED PARTY TRANSACTIONS

PepsiCo is considered a related party due to the nature of our franchise relationship and its ownership interest in our company. The most significant agreements that govern our relationship with PepsiCo consist of:

- (1) The master bottling agreement for cola beverages bearing the “PEPSI-COLA” and “PEPSI” trademarks in the United States; master bottling agreements and distribution agreements for non-cola products in the United States; and a master fountain syrup agreement in the United States;
- (2) Agreements similar to the master bottling agreement and the non-cola agreements for each country in which we operate, including Canada, Spain, Russia, Greece, Turkey and Mexico, as well as a fountain syrup agreement for Canada, similar to the master syrup agreement;
- (3) A shared services agreement where we obtain various services from PepsiCo, which includes services for information technology maintenance and the procurement of raw materials. We also provide services to PepsiCo, including facility and credit and collection support. The amounts paid or received under this contract are equal to the actual costs incurred by the company providing the service; and

- (4) Transition agreements that provide certain indemnities to the parties, and provide for the allocation of tax and other assets, liabilities and obligations arising from periods prior to the initial public offering. Under our tax separation agreement, PepsiCo maintains full control and absolute discretion for any combined or consolidated tax filings for tax periods ended on or before the initial public offering.

Additionally, we review our annual marketing, advertising, management and financial plans each year with PepsiCo for its approval. If we fail to submit these plans, or if we fail to carry them out in all material respects, PepsiCo can terminate our beverage agreements. If our beverage agreements with PepsiCo are terminated for this or for any other reason, it would have a material adverse effect on our business and financial results.

Bottler Incentives and Other Arrangements – We share a business objective with PepsiCo of increasing the availability and consumption of Pepsi-Cola beverages. Accordingly, PepsiCo, at its discretion, provides us with various forms of bottler incentives to promote its beverages. These incentives are mutually agreed upon between us and PepsiCo and cover a variety of initiatives, including direct marketplace support, capital equipment funding and advertising support. Based on the objectives of the programs and initiatives, we record bottler incentives as an adjustment to net revenues, cost of sales or selling, delivery and administrative expenses. Beginning in 2003, due to the adoption of EITF Issue No. 02-16, we changed our accounting methodology for the way we record bottler incentives. See Note 2 - Summary of Significant Accounting Policies for a discussion of the change in classification of these bottler incentives in our Consolidated Statements of Operations.

Bottler incentives received from PepsiCo, including media costs shared by PepsiCo, were \$626 million, \$646 million and \$560 million for 2004, 2003 and 2002, respectively. Changes in our bottler incentives and funding levels could materially affect our business and financial results.

Purchases of Concentrate and Finished Product – We purchase concentrate from PepsiCo, which is the critical flavor ingredient used in the production of carbonated soft drinks and other ready-to-drink beverages. PepsiCo determines the price of concentrate annually at its discretion. We also pay a royalty fee to PepsiCo for the AQUAFINA trademark. Amounts paid or payable to PepsiCo and its affiliates for concentrate

and royalty fees were \$2,075 million, \$1,971 million and \$1,699 million in 2004, 2003 and 2002, respectively.

We also produce or distribute other products and purchase finished goods and concentrate through various arrangements with PepsiCo or PepsiCo joint ventures. During 2004, 2003 and 2002, total amounts paid or payable to PepsiCo or PepsiCo joint ventures for these transactions were \$666 million, \$556 million and \$464 million, respectively.

Manufacturing and Distribution Service Reimbursements – In 2003 and 2002, we provided manufacturing services to PepsiCo and PepsiCo affiliates in connection with the production of certain finished beverage products. During 2003 and 2002, total amounts paid or payable by PepsiCo for these transactions were \$6 million and \$10 million, respectively.

Fountain Service Fee – We manufacture and distribute fountain products and provide fountain equipment service to PepsiCo customers in some territories in accordance with the Pepsi beverage agreements. Amounts received from PepsiCo for these transactions are offset by the cost to provide these services and are reflected in our Consolidated Statements of Operations in selling, delivery and administrative expenses. Net amounts paid or payable by PepsiCo to us for these services were approximately \$180 million, \$200 million and \$200 million, in 2004, 2003 and 2002, respectively.

Shared Services – We provide and receive various services from PepsiCo and PepsiCo affiliates pursuant to a shared services agreement and other arrangements. Total expenses incurred with PepsiCo and PepsiCo affiliates were approximately \$68 million, \$72 million and, \$70 million during 2004, 2003 and 2002, respectively, and are reflected in selling, delivery and administrative expenses in our Consolidated Statements of Operations. Total income generated for services provided to PepsiCo and PepsiCo affiliates was approximately \$10 million, \$10 million and \$13 million during 2004, 2003 and 2002, respectively, and is reflected in selling, delivery and administrative expenses in our Consolidated Statements of Operations.

Frito-Lay Purchases – We purchase snack food products from Frito-Lay, Inc., a subsidiary of PepsiCo, for sale and distribution in Russia. Amounts paid or payable to PepsiCo and its affiliates for snack food products were \$75 million, \$51 million and \$44 million in 2004, 2003 and 2002, respectively.

Income Tax Expense – Under tax sharing arrangements we have with PepsiCo, we received \$17 million, \$7 million and \$3 million in tax-related benefits from PepsiCo in 2004, 2003 and 2002, respectively.

The Consolidated Statements of Operations include the following income (expense) amounts as a result of transactions with PepsiCo and its affiliates:

	2004	2003	2002
Net revenues:			
Bottler incentives	\$ 22	\$ 21	\$ 257
Cost of sales:			
Purchases of concentrate and finished products, and AQUAFINA royalty fees	\$(2,741)	\$(2,527)	\$(2,163)
Bottler incentives	522	527	–
Manufacturing and distribution service reimbursements	–	6	10
	\$(2,219)	\$(1,994)	\$(2,153)

Selling, delivery and administrative expenses:			
Bottler incentives	\$ 82	\$ 98	\$ 303
Fountain service fee	180	200	200
Frito-Lay purchases	(75)	(51)	(44)
Shared services	(58)	(62)	(57)
	\$ 129	\$ 185	\$ 402
Income tax expense	\$ 17	\$ 7	\$ 3

We are not required to pay any minimum fees to PepsiCo, nor are we obligated to PepsiCo under any minimum purchase requirements.

We paid PepsiCo \$1 million, \$3 million and \$10 million during 2004, 2003 and 2002, respectively, for distribution rights relating to the SOBE brand in certain PBG-owned territories in the U.S. and Canada.

Bottling Group, LLC will distribute pro rata to PepsiCo and PBG, based upon membership interest, sufficient cash such that aggregate cash distributed to us will enable us to pay our income taxes and interest on our \$1 billion 7.0% senior notes due 2029. PepsiCo’s pro-rata cash distribution during 2004, 2003 and 2002 from Bottling Group, LLC was \$13 million, \$7 million and \$11 million, respectively.

Amounts receivable from PepsiCo and its affiliates at December 25, 2004 were \$6 million. Such amounts are recorded in prepaid and other current assets in our Consolidated Balance Sheets. Amounts payable to PepsiCo and its affiliates at December 27, 2003 were \$20 million. Such amounts are recorded within accounts payable and other current liabilities in our Consolidated Balance Sheets.

Board of Directors

Two of our board members are employees of PepsiCo. Neither of these board members serves on our Audit and Affiliated Transactions Committee, Compensation and Management Development Committee or Nominating and Corporate Governance Committee. In addition, one of the managing directors of Bottling Group, LLC, our principal operating subsidiary, is an employee of PepsiCo.

NOTE 16 CONTINGENCIES

We are subject to various claims and contingencies related to lawsuits, taxes, environmental and other matters arising out of the normal course of business. We believe that the ultimate liability arising from such claims or contingencies, if any, in excess of amounts already recognized is not likely to have a material adverse effect on our results of operations, financial condition or liquidity.

In 1995, a class action suit was filed against three of our suppliers for price fixing on the sale of high fructose corn syrup during the years between 1991 and 1995. During this time period we were still part of PepsiCo. During 2004, these suppliers have settled their respective charges. Settlement of damages will be allocated to each class action recipient based on its percentage of purchases of the high fructose corn syrup from these suppliers during the period 1991 through 1995. We believe the claims process for the allocation of settlement to each class action recipient will be finalized during 2005. Currently, we can not reasonably estimate the amount of proceeds we will receive from the settlement of this case and accordingly have not recorded a gain during 2004.

As of December 25, 2004, we employed approximately 64,700 workers, of whom approximately 31,700 were employed in the United States. Approximately 8,900 of our workers in the United States are union members and approximately 16,900 of our workers outside the United States are union members. Approximately 50% of the union members in the United States are covered under contracts

that will expire in 2005. We consider relations with our employees to be good and have not experienced significant interruptions of operations due to labor disagreements in the past.

NOTE 17 ACQUISITIONS

During 2004, we acquired the operations and exclusive right to manufacture, sell and distribute Pepsi-Cola beverages from four franchise bottlers. The following acquisitions occurred for an aggregate purchase price of \$95 million in cash and assumption of liabilities of \$22 million:

- Gaseosas, S.A. de C.V. of Mexicali, Mexico in March
- Seltzer and Rydholm, Inc. of Auburn, Maine in October
- Phil Gaudreault et Fils Ltee of Quebec, Canada in November
- Bebidas Purificada, S.A. de C.V. of Juarez, Mexico in November

As a result of these acquisitions, we have assigned \$5 million to goodwill, \$66 million to franchise rights and \$3 million to non-compete arrangements. The goodwill and franchise rights are not subject to amortization. The non-compete agreements are being amortized over five to ten years. The allocations of the purchase price for these acquisitions are still preliminary and will be determined based on the estimated fair value of assets acquired and liabilities assumed as of the dates of acquisitions. The operating results of each of our acquisitions are included in our Consolidated Financial Statements from its respective date of purchase. These acquisitions were made to enable us to provide better service to our large retail customers. We expect these acquisitions to reduce costs through economies of scale.

During 2004, we also paid \$1 million for the purchase of certain distribution rights relating to SOBE.

During 2003, we acquired the operations and exclusive right to manufacture, sell and distribute Pepsi-Cola beverages from three franchise bottlers. The following acquisitions occurred for an aggregate purchase price of \$91 million in cash and assumption of liabilities of \$13 million:

- Pepsi-Cola Buffalo Bottling Corp. of Buffalo, New York in February
- Cassidy’s Beverage Limited of New Brunswick, Canada in February
- Olean Bottling Works, Inc. of Olean, New York in August

As a result of these acquisitions, we have assigned \$7 million to goodwill, \$76 million to franchise rights and \$5 million to non-compete arrangements. The goodwill and franchise rights are not subject to amortization. The non-compete agreements are being amortized over five years.

During 2003, we also paid \$5 million for the purchase of certain distribution rights relating to SOBE and DR PEPPER and paid \$4 million for purchase obligations relating to acquisitions made in the prior year.

NOTE 18 ACCUMULATED OTHER COMPREHENSIVE LOSS

The year-end balances related to each component of accumulated other comprehensive loss were as follows:

	2004	2003	2002
Net currency translation adjustment	\$(111)	\$(195)	\$(285)
Cash flow hedge adjustment ⁽¹⁾	10	13	(5)
Minimum pension liability adjustment ⁽²⁾	(214)	(198)	(178)
Accumulated other comprehensive loss	\$(315)	\$(380)	\$(468)

- (1) Net of minority interest and taxes of \$(7) million in 2004, \$(9) million in 2003 and \$4 million in 2002.
- (2) Net of minority interest and taxes of \$161 million in 2004, \$148 million in 2003 and \$134 million in 2002.

NOTE 20 SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

	First Quarter	Second Quarter	Third Quarter	Fourth ⁽¹⁾⁽²⁾ Quarter	Full Year
2004					
Net revenues	\$2,067	\$2,675	\$2,934	\$3,230	\$10,906
Gross profit	1,016	1,297	1,412	1,525	5,250
Operating income	137	286	357	196	976
Net income	50	142	191	74	457
	First Quarter	Second Quarter	Third Quarter	Fourth ⁽³⁾ Quarter	Full Year
2003					
Net revenues	\$1,874	\$2,532	\$2,810	\$3,049	\$10,265
Gross profit	947	1,242	1,372	1,489	5,050
Operating income	120	271	358	207	956
Net income	33	131	183	69	416

- (1) Includes Mexico tax law change benefit of \$26 million and international tax restructuring charge of \$30 million.
- (2) Includes a \$9 million non-cash impairment charge (\$6 million net of tax and minority interest) relating to our re-evaluation of the fair value of our franchise licensing agreement for the SQUIRT trademark in Mexico.
- (3) Includes Canada tax law change expense of \$11 million.

NOTE 19 COMPUTATION OF BASIC AND DILUTED EARNINGS PER SHARE

(shares in thousands)	2004	2003	2002
Number of shares on which basic earnings per share are based:			
Weighted-average outstanding during period	255,061	269,933	281,674
Add – Incremental shares under stock compensation plans	8,423	6,986	11,116
Number of shares on which diluted earnings per share are based:	263,484	276,919	292,790
Basic and diluted net income applicable to common shareholders	\$ 457	\$ 416	\$ 428
Basic earnings per share	\$1.79	\$1.54	\$1.52
Diluted earnings per share	\$1.73	\$1.50	\$1.46

Diluted earnings per share reflect the potential dilution that could occur if the stock options or other equity awards from our stock compensation plans were exercised and converted into common stock that would then participate in net income. Options to purchase 6.8 million shares at December 25, 2004, 14.3 million shares at December 27, 2003, and 0.2 million shares at December 28, 2002 are not included in the computation of diluted earnings per share because the effect of including the options in the computation would be antidilutive.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
The Pepsi Bottling Group, Inc.:

We have audited the accompanying consolidated balance sheets of The Pepsi Bottling Group, Inc. and subsidiaries as of December 25, 2004 and December 27, 2003, and the related consolidated statements of operations, cash flows and changes in shareholders’ equity for each of the fiscal years in the three-year period ended December 25, 2004. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position

of The Pepsi Bottling Group, Inc. and subsidiaries as of December 25, 2004 and December 27, 2003, and the results of their operations and their cash flows for each of the fiscal years in the three-year period ended December 25, 2004, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, the Company adopted Emerging Issues Task Force Issue No. 02-16, “Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor,” as of December 29, 2002.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of The Pepsi Bottling Group, Inc.’s internal control over financial reporting as of December 25, 2004, based on criteria established in “Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO),” and our report dated February 25, 2005 expressed an unqualified opinion on management’s assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

New York, New York
February 25, 2005

Management’s Report on Internal Control Over Financial Reporting

To Our Shareholders:

We are responsible for establishing and maintaining adequate internal control over financial reporting for The Pepsi Bottling Group, Inc. (the “Company”). Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles and includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company’s assets that could have a material effect on the financial statements.

As required by Section 404 of the Sarbanes–Oxley Act of 2002 and the related rule of the Securities and Exchange Commission, we assessed the effectiveness of the Company’s internal control over financial reporting using the “Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).”

Based on our assessment, we concluded that the Company’s internal control over financial reporting was effective as of December 25, 2004. We have not identified any material weaknesses in the Company’s internal control over financial reporting as of December 25, 2004.

Our independent auditors, KPMG LLP (“KPMG”), who have audited and reported on our financial statements, issued an attestation report on our assessment of the Company’s internal control over financial reporting. KPMG’s reports are included in this annual report.

John T. Cahill

Alfred H. Drewes

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
The Pepsi Bottling Group, Inc.:

We have audited management’s assessment, included in the accompanying Management’s Report on Internal Control Over Financial Reporting, that The Pepsi Bottling Group, Inc. maintained effective internal control over financial reporting as of December 25, 2004, based on criteria established in “Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).” The Pepsi Bottling Group, Inc.’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management’s assessment and an opinion on the effectiveness of The Pepsi Bottling Group, Inc.’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management’s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company

are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management’s assessment that The Pepsi Bottling Group, Inc. maintained effective internal control over financial reporting as of December 25, 2004, is fairly stated, in all material respects, based on criteria established in “Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).” Also, in our opinion, The Pepsi Bottling Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 25, 2004, based on criteria established in “Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).”

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of The Pepsi Bottling Group, Inc. and subsidiaries as of December 25, 2004 and December 27, 2003, and the related consolidated statements of operations, cash flows and changes in shareholders’ equity for each of the fiscal years in the three-year period ended December 25, 2004, and our report dated February 25, 2005, expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

New York, New York
February 25, 2005

Selected Financial and Operating Data

Fiscal years ended in millions, except per share data	2004	2003	2002	2001	2000 ⁽¹⁾
Statement of Operations Data:					
Net revenues	\$10,906	\$10,265	\$9,216	\$8,443	\$7,982
Cost of sales	5,656	5,215	5,001	4,580	4,405
Gross profit	5,250	5,050	4,215	3,863	3,577
Selling, delivery and administrative expenses	4,274	4,094	3,317	3,187	2,987
Operating income	976	956	898	676	590
Interest expense, net	230	239	191	194	192
Other non-operating expenses, net	1	7	7	—	1
Minority interest	56	50	51	41	33
Income before income taxes	689	660	649	441	364
Income tax expense ⁽²⁾⁽³⁾⁽⁴⁾	232	238	221	136	135
Income before cumulative effect of change in accounting principle	457	422	428	305	229
Cumulative effect of change in accounting principle, net of tax and minority interest	—	6	—	—	—
Net income	\$ 457	\$ 416	\$ 428	\$ 305	\$ 229
Per Share Data:⁽⁵⁾					
Basic earnings per share	\$ 1.79	\$ 1.54	\$ 1.52	\$ 1.07	\$ 0.78
Diluted earnings per share	\$ 1.73	\$ 1.50	\$ 1.46	\$ 1.03	\$ 0.77
Cash dividend per share	\$ 0.16	\$ 0.04	\$ 0.04	\$ 0.04	\$ 0.04
Weighted-average basic shares outstanding	255	270	282	286	294
Weighted-average diluted shares outstanding	263	277	293	296	299
Other Financial Data:					
Cash provided by operations	\$ 1,251	\$ 1,084	\$ 1,014	\$ 882	\$ 779
Capital expenditures	\$ (717)	\$ (644)	\$ (623)	\$ (593)	\$ (515)
Balance Sheet Data (at period end):					
Total assets	\$10,793	\$11,544	\$10,043	\$7,857	\$7,736
Long-term debt	\$ 4,489	\$ 4,493	\$ 4,539	\$3,285	\$3,271
Minority interest	\$ 445	\$ 396	\$ 348	\$ 319	\$ 306
Accumulated other comprehensive loss	\$ (315)	\$ (380)	\$ (468)	\$ (370)	\$ (254)
Shareholders' equity	\$ 1,949	\$ 1,881	\$ 1,824	\$1,601	\$1,646

(1) Our fiscal year 2000 results were impacted by the inclusion of an extra week in our fiscal year. The extra week increased net income by \$7 million, or \$0.02 per share.

(2) Fiscal year 2001 includes Canada tax law change benefits of \$25 million.

(3) Fiscal year 2003 includes Canada tax law change expense of \$11 million.

(4) Fiscal year 2004 includes Mexico tax law change benefit of \$26 million and international tax restructuring charge of \$30 million.

(5) Reflects the 2001 two-for-one stock split.

Corporate Headquarters**The Pepsi Bottling Group, Inc.**

1 Pepsi Way
Somers, NY 10589
914.767.6000

Transfer Agent

For services regarding your account such as change of address, replacement of lost stock certificates or dividend checks, direct deposit of dividends, or change in registered ownership, contact:

The Bank of New York

Shareholder Services Department
P.O. Box 11258
Church Street Station
New York, NY 10286-1258

Telephone: 800.432.0140

E-mail: shareowner-svcs@bankofny.com

Website: <http://www.stockbny.com>

Or

The Pepsi Bottling Group, Inc.

Shareholder Relations Coordinator

1 Pepsi Way

Somers, NY 10589

Telephone: 914.767.6339

In all correspondence or telephone inquiries, please mention PBG, your name as printed on your stock certificate, your Social Security number, your address and telephone number.

Direct Purchase and Sales Plan

The BuyDIRECT Plan, administered by The Bank of New York, provides existing shareholders and interested first-time investors a direct, convenient and affordable alternative for buying and selling PBG shares. Contact The Bank of New York for an enrollment form and brochure that describes the plan fully. For BuyDIRECT Plan enrollment and other shareholder inquiries:

The Pepsi Bottling Group, Inc.

c/o The Bank of New York
P.O. Box 11019
New York, NY 10286-1019
Telephone: 800.432.0140

Stock Exchange Listing

Common shares (symbol: PBG) are traded on the New York Stock Exchange.

PBG
LISTED
NYSE.

Certifications

The certifications of our Chief Executive Officer and Chief Financial Officer, as required by section 302 of the Sarbanes-Oxley Act, are included as exhibits to PBG's 2004 Annual Report on Form 10-K filed with the SEC. PBG submitted its annual certification regarding corporate governance listing standards to the New York Stock Exchange after its 2004 Annual Meeting of Shareholders.

Independent Public Accountants**KPMG LLP**

345 Park Avenue
New York, NY 10154

Annual Meeting

The annual meeting of shareholders will be held at 10:00 a.m., Wednesday, May 25, 2005, at PBG headquarters in Somers, New York.

Investor Relations

PBG's 2005 quarterly releases are expected to be issued the weeks of April 11, July 4 and September 26, 2005, and January 30, 2006.

Earnings and other financial results, corporate news and other company information are available on PBG's website: <http://www.pbg.com>

Investors desiring further information about PBG should contact the Investor Relations department at corporate headquarters at 914.767.6339.

Institutional investors should contact MaryWinn Settino at 914.767.7216.

This publication contains many of the valuable trademarks owned and used by PepsiCo, Inc. and its subsidiaries and affiliates in the United States and internationally.



THE PEPSI BOTTLING GROUP

1 Pepsi Way
Somers, NY 10589

www.pbg.com